EXTENSION OF ROYALTY ADJUSTMENT ACT

HEARINGS

BEFORE

SUBCOMMITTEE NO. 3

COMMITTEE ON THE JUDICIARY

HOUSE OF REPRESENTATIVES

EIGHTY-THIRD CONGRESS

FIRST SESSION

ON

H. R. 2560

A BILL TO CONTINUE THE EFFECTIVENESS OF THE PROVISIONS OF THE ACT OF OCTOBER 31, 1942, AS EXTENDED, RELATING TO THE ADJUSTMENT OF ROYALTIES, FOR THE DURATION OF THE NATIONAL EMERGENCY PROCLAIMED DECEMBER 16, 1950, AND SIX MONTHS THEREAFTER

APRIL 29, 1953

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[1] Elected to committee March 30, 1953 (H. Res. 194). Hon. Joseph R. Bryson, of South Carolina, a member of this committee, died on March 10, 1953.

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EXTENSION OF ROYALTY ADJUSTMENT ACT

WEDNESDAY, APRIL 29, 1953

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE NO. 3 OF THE COMMITTEE ON THE JUDICIARY,
Washington, D. C.

The subcommittee met, pursuant to notice, at 10 a. m., in room 445, Old House Building, Washington, D. C., Hon. Shepard J. Crumpacker, Jr., acting chairman, presiding.

Present: Messrs. Crumpacker (Indiana), Fine (New York), and Taylor (New York).

Also present: Mr. William Foley, committee counsel.

MR. CRUMPACKER. This is a hearing on H. R. 2560.

The first witness is Mr. Milans.

(H. R. 2560 is as follows:)

[H. R. 2560, 83d Cong., 1st sess.]

A BILL To continue the effectiveness of the provisions of the Act of October 31, 1942, as extended, relating to the adjustment of royalties, for the duration of the national emergency proclaimed December 16, 1950, and six months thereafter

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the provisions of the Act of October 31, 1942 (ch. 634, 56 Stat. 1013) as amended, as extended by section 1 (a) (31) of the Emergency Powers Continuation Act (Public Law 450, Eighty-second Congress) shall remain in full force and effect until six months after the termination of the national emergency proclaimed by the President on December 16, 1950 (Proc. 2914, 3 C. F. R. 71), notwithstanding any limitation by reference to war of the time during which or the purposes for which powers and authorizations thereunder may be exercised.

STATEMENT OF R. S. MILANS, HEAD, CONTRACT AND ROYALTY NEGOTIATIONS BRANCH, OFFICE OF NAVAL RESEARCH, ACCOMPANIED BY RAYMOND F. HOSSFELD, DIRECTOR OF PATENTS, OFFICE OF NAVAL RESEARCH

MR. MILANS. My name is Robert S. Milans. I am head of the Contract and Royalty Negotiations Branch, Patents Division, Office of Naval Research, Department of the Navy. I have with me Mr. Raymond F. Hossfeld, Director of Patents, Office of Naval Research, Department of the Navy, who will assist me in answering any questions the committee may wish to ask.

Because I have been closely and continuously associated with the administration of the Royalty Adjustment Act of 1942 by the 3 services for a period of more than 9 years, I have been designated as a witness for the Department of Defense in support of H. R. 2560.

H. R. 2560 proposes to continue sections 1 and 2 of the Royalty Adjustment Act of 1942 (35 U. S. C. 89, 90), as amended and extended

by section 1 (a) (31) of the Emergency Powers Continuation Act, Public Law 450, 82d Congress, in full force and effect until 6 months after the termination of the national emergency proclaimed by the President on December 16, 1950, notwithstanding any limitation by reference to war of the time during which or the purposes for which powers and authorizations thereunder may be exercised.

Sections 1 and 2 of the Royalty Adjustment Act of 1942 as amended and extended will expire on July 1, 1953, and provide that whenever a patented or unpatented invention is manufactured, used, or sold for the United States under a license calling for the payment of royalties which are believed to be unreasonable or excessive by the head of a Government agency concerned, that the licensor and licensee shall be notified of such fact. Within a reasonable time thereafter and after a hearing if requested by the licensor or licensee, the head of the Government agency concerned may by order fix and specify such royalties as are determined to be fair and just and authorize the payment thereof by the license to the licensor. The licensor's sole and exclusive remedy if he believes himself injured by any order is by suit against the United States to recover such sum, if any, as when added to the royalties fixed and specified in the order will constitute fair and just compensation to the licensor.

During World War II it was found that numerous Government contractors were manufacturing under license agreements by which they were obligated to pay royalties based upon returns appropriate to periods of normal production. While the royalties for these earlier periods were fair and reasonable, in many instances they became unreasonable or excessive when applied to the enormous increase in production during the war period. Since excessive royalties required to be paid by the contractor were passed on to the Government, legislation was sought to remedy this situation which resulted in the Royalty Adjustment Act of 1942 under sections 1 and 2 of which fair and just royalties could be fixed taking into account the conditions of wartime production. Any reduction in royalties effected under this act inured to the benefit of the Government by way of a corresponding reduction in the contract price or by way of refund if already paid to the licensee.

In operating under this act during the period from 1942 to mid-1945 some 2,800 cases were examined for excessive royalties which resulted in some 500 settlement agreements voluntarily entered into by licensors, the issuance of some 40 orders and estimated savings totaling well over $0.5 billion by June 30, 1945. Many of these voluntary agreements in adjustment of royalties terminated with the cessation of hostilities and the remaining voluntary agreements with but few exceptions terminated 6 months after the end of World War II. A number of the orders issued under the act are also no longer in force as a result of settlement agreements voluntarily entered into after the issuance of the orders.

The Government is now committed to a defense program of large proportions and production of munitions is being expanded and accelerated. As an indication of the magnitude of the program it may be noted that during World War II the United States produced about $160 billion worth of munitions valued at about $300 billion in 1952 dollars. Under the current defense program more than one-third of that amount has been appropriated for munitions since mid-1950 and

additional funds are being requested. It is estimated that current expenditures for the production of munitions are at a rate of about $30 billion annually and will continue to be substantial for at least 2 or more years. The conditions, therefore, which prompted legislation resulting in the Royalty Adjustment Act of 1942 are again present.

In view of the current substantial increase in military procurement and the prospect that the national economy is facing a period of expanded production for defense purposes for several years to come, it is essential that this act be continued in full force so that the Government may be protected against the payment of excessive royalties which are based upon royalty rates appropriate to periods of normal production. The Department of Defense therefore urgently recommends that sections 1 and 2 of the Royalty Adjustment Act of 1942 as amended be retained in force as proposed in this bill.

Mr. CRUMPACKER. Do you have any figures as to how many of these 2,800 cases that you refer to involve corporation-owned patents?

Mr. MILANS. Sir, I am sorry. I have a report which I have referred to in my previous testimony which is made by the Army and Navy to Senator Kilgore, was made back in June 1946, in which we summarized our work which had been done. We had certain tables in the back, but they do not state. They give it by case number rather than by name involved. I do not have those figures. I believe that a majority of them involve corporations.

Mr. CRUMPACKER. I would like to refer now to the half billion dollar estimated saving. Do you have any estimate of how much of that half billion dollars might have been recovered through Federal taxation?

Mr. MILANS. No, sir.

Mr. CRUMPACKER. How many cases have been handled since the start of the Korean emergency?

Mr. MILANS. At the present time, there are 70 cases under investigation and a total of 22 notices have been issued.

Mr. CRUMPACKER. You mean that is 22 in addition to the 70?

Mr. MILANS. In addition to the 70; yes, sir. But out of that 22, in one case that we know of there are identical Army and Air Force notices, so that under the present law, the head of each department, agency, if it comes down to a notice or order, has to issue its own notice because the law as presently drafted, Public Law 78, 77th Congress, states that the head of any department or agency may issue notice and may issue order if he believes the royalty to be unreasonable or excessive.

Therefore, out of this 22, that would be at least 1 duplicate notice we know of between the Navy and the Air Force; so it would reduce it down to, let us say, 21 cases, although it may be 22 notices.

Mr. CRUMPACKER. Have any of these cases reached a state of final determination since the Korean emergency?

Mr. MILANS. Since July 1, 1950, which we take as the convenient point for the Korean crisis, there has been a total of 17 royalty-adjustment agreements incorporated. No orders have been issued yet.

Mr. CRUMPACKER. Do you have any estimate on what saving might have been involved in those cases?

Mr. MILANS. Yes, sir; estimated savings which have been made under cases which arose under the period July 1, 1950, to February 1, 1953, are $2,345,131.

Mr. CRUMPACKER. I see.

Have you anything further?

Mr. MILANS. Yes, sir; if I may proceed with this supplemental statement. Let me give you first the legislative history and need for the act.

PURPOSE OF THE ACT

The Royalty Adjustment Act, Public Law 768 (35 U. S. C. 89–96), was enacted primarily to:

One, eliminate the payment of excessive patent royalties on war production; and

Two, permit the Government to utilize patented and unpatented inventions through the medium of any desired source of supply, without having to pay more than a fair and just compensation to the owners of such inventions.

EXTENSION OF THE ACT

Under the provisions of sections 1 and 2 of the act, as originally enacted, authority to adjust patent royalties, required to be paid by the Government contractor and passed on to the Government as an item of cost, would have terminated 6 months after termination of World War II.

Interim legislation relating to emergency laws, of which authority to adjust royalties as provided for under sections 1 and 2 of the Royalty Adjustment Act was a part, was enacted by Congress, as follows:

To June 1, 1952, by Public Law 313, 82d Congress, 2d session, chapter 204, approved April 14, 1952.

To June 15, 1952, by Public Law 368, 82d Congress, 2d session, chapter 339, approved May 28, 1952.

To June 30, 1952, by Public Law 393, 82d Congress, 2d session, chapter 437, approved June 14, 1952.

To July 3, 1952, by Public Law 428, 82d Congress, 2d session, chapter 526, approved June 30, 1952.

To April 1, 1953, by Public Law 450, 82d Congress, 2d session, chapter 570, approved July 3, 1952.

To July 1, 1953, by Public Law 12, 83d Congress, 1st session, chapter 13, approved March 31, 1953.

Comment: By Public Law 450, the act was not only extended but was amended to make its provisions applicable to a period in which there is no formally declared state of war, part of this legislation reading as follows:

> Act of October 31, 1942 (ch. 534, 56 Stat. 1013; 35 U. S. C. 89 and note and 90–96): and, effective for the period of time provided for in the opening paragraph of this subsection, the terms "prosecution of the war" and "conditions of wartime production," as used in said act of October 31, 1942, include, respectively, prosecution of defense activities and conditions of production during the national emergency proclaimed by the President on December 16, 1950.

The text of the House committee report on Public Law 450, H. Rept. No. 2041, 82d Congress, 2d session, page 25, with respect to the con-

tinuation of sections 1 and 2 of the Royalty Adjustment Act, reads in pertinent part as follows:

> The committee recommends that this item be continued, with language clarifying its application to a period in which there is no formally declared state of war.
>
> The committee is mindful that such intervention on the part of the Government is an invasion of the right of contract between the licensor and the licensee; a contract to which the Government was not a party. Nevertheless the committee is of the opinion that when a period of war or national emergency exists an individual is not entitled to excessive profits but rather owes a duty to the country to accept what is reasonable compensation under the circumstances.

JUSTIFICATION FOR THE ACT

Under the act of June 25, 1910, as amended, 28 United States Code 1498, if no license agreement exists between the owner of an invention and a Government contractor, the Government in appropriate cases can and does use all inventions deemed essential in its procurement program and the owner's sole remedy is a suit against the United States in the Court of Claims for the recovery of his reasonable and entire compensation.

On the other hand, in cases where the owner of a patent has licensed a Government contractor to use the invention, the Government is in the peculiar position of having the statutory right to use inventions through unlicensed contractors for a reasonable compensation but is unable to use the same inventions through a licensed contractor except by paying royalties stipulated in a preexisting license agreement to which the Government had not been a party and under which royalty payments fixed during peacetime may be more than reasonable compensation based upon Defense procurement.

Such differences between the costs in connection with procurement involving the use of unlicensed inventions under the 1910 act and that of licensed inventions are equalized by the Royalty Adjustment Act. The Royalty Adjustment Act thus implements the act of 1910 by permitting the Government to purchase materials and supplies at the same cost for the use of any inventions involved irrespective of whether or not the contractor is licensed by the patent owner.

PAYMENT OF ROYALTIES IN MANY INSTANCES UNJUSTIFIED

Payment of royalties at rates specified in preexisting license agreements are unjustified, either in whole or in part, in such situations as the following:

Where the royalties based on a period of normal production become excessive or unreasonable when applied to expanded production under the current defense program.

Non-arms-length negotiation of license agreement, namely, where the license agreement is between the owner of the invention, as licensor, and a corporation, as licensee, which latter is wholly owned or controlled by licensor.

Where a patent is invalid, that is, as by anticipation.

Basic patent expired, and improvement patents cover merely unimportant details.

Where, because of Government specifications, the item is more costly than a similar item sold in the commercial market.

Where the patent involved does not cover the particular item of procurement.

INADEQUACY OF RENEGOTIATION ACT

The Renegotiation Act of 1951, Public Law 9, 82d Congress, is inadequate to protect the interest of the Government against unreasonable or excessive royalty charges for the following reasons:

Under the provisions of section 105 (f) of the Renegotiation Act of 1951, the act applies only in those cases where the aggregate renegotiable royalties exceed $250,000 for each year subject to renegotiation. Experience has demonstrated that it is quite common to find that in cases where the royalty income for a fiscal year is below the statutory floor of $250,000, the royalties are nevertheless exorbitant and excessive and do not reflect the reasonable value for the use of the invention. Therefore, where the royalties are exempted under the Renegotiation Act, an adjustment can be made only under the Royalty Adjustment Act in order that the Government be not required to pay more than a fair and just compensation for the use of the invention involved.

If the royalty income is less than $250,000 per year and therefore not subject to the Renegotiation Act, then in the absence of the Royalty Adjustment Act the foreign owner of United States patents is in a preferred position since his royalties would not be subject to adjustment while a United States citizen who owns foreign patents, at least in England, would be subject to adjustment of his royalties.

The Renegotiation Act of 1951 does not, as does the Royalty Adjustment Act, apply to all owners of inventions utilized in Government procurement, nor does it apply either to all licensors or to all Government contractors and suppliers alike.

Under renegotiation the licensor makes a refund of the amount of royalties found to be excessive and the procuring activities receive no benefit in the way of a reduction in costs such as may occur where the royalty rate is reduced under the Royalty Adjustment Act. This reduction in cost under the Royalty Adjustment Act may inure immediately to the benefit of the procuring activities, whereas a considerable time may elapse before a refund would be made under the Renegotiation Act.

INADEQUACY OF INCOME-TAX LAW

Upon the Income Tax Statutes, chapter 1, relating to income taxes, and chapter 2, subchapter E, relating to excess-profit taxes, even though a part of the royalties may be later recovered in the form of taxes, the procuring activities cannot obtain the immediate benefit of reduced costs as may occur were a reduction in the royalty rate has been effected under the Royalty Adjustment Act.

Now, I would like to take up part II, "Administration of the Act."

ACT APPLIES ONLY TO ROYALTIES CHARGED OR CHARGEABLE TO THE GOVERNMENT

It should be clearly understood that any adjustment of royalties under the act relates only to those royalties that accrue on sales to or for the Government. Thus, the licensor and licensee are free to continue, or change or amend the provisions of their license agree-

ment in any manner they so desire insofar as normal commercial relations and non-Government sales are concerned.

ROYALTY ADJUSTMENT BOARDS

Pursuant to section 5 of the Royalty Adjustment Act the Secretaries of the several Defense Departments have established one or more "Boards" within their respective departments for administering the act. Thus the Navy Department has a single Patent Royalty Revision Board composed of the Chief of Naval Research as Chairman and seven members selected and appointed by the Secretary of the Navy from personnel of procurement bureaus having a general background in contractural and procurement matters coupled with some knowledge of production and frequently also experienced in legal and/or patent matters. The Air Force likewise has but a single board, situated at the Air Materiel Command. The Army has a board established in each of the several technical services.

ROYALTY ADJUSTMENT PROCEDURE

First, we have the source of royalty information and the screening of same. Information relating to royalties charged or chargeable to the Government is obtained from Government contractors, through renegotiation, contract clearance, and the like. During the course of negotiating a governmental contract, for example, information relating to royalty payments as an item of cost to the Government may be submitted by the contractor or such information may be submitted during performance under a contract in the form of a royalty report as required by the terms of the contract. Any royalty data so supplied are reviewed to ascertain whether or not further inquiry as to the reasonableness or excessiveness of the royalties is justified.

For the Navy Department the information respecting royalties is forwarded to ONR, where it is reviewed by personnel under supervision of counsel for the Navy Patent Royalty Revision Board. In the Army and Air Force it may go to the technical service having primary cognizance.

If on the basis of the foregoing information the royalties on any procurement item appear to be reasonable, no further action is taken but, from time to time, future procurement of that particular item may be inquired into and checked to determine whether or not the amount of royalty payments charged as an item of cost to the Government is substantially increasing out of proportion to the reasonable value of the invention when applied to the expanding volume of procurement.

If upon the basis of such screening action royalties charged or chargeable to the Government appear to be unreasonable or excessive either as to the rate or the amount thereof, a further preliminary investigation is initiated.

PRELIMINARY INVESTIGATION

This investigation, in general, consists of:

First, obtaining data from the procurement activities of the agency involved with respect to present, future, or contemplated procurement

of the item with respect to which the royalties in question are charged or chargeable to the Government.

Second, corresponding with the licensor or licensee for the purpose of obtaining a copy of the license agreement covering the royalties in question, the amount of royalties paid to the licensor over a period, namely, from January 1, 1946 to December 31, 1952, and any and all other information which the licensor or licensee may desire to furnish having a bearing upon the reasonableness of the royalties in the particular case.

Third, evaluating the information obtained under first and second above to determine whether or not, in the light of all such information, royalty adjustment action should be taken.

ADJUSTMENT OF ROYALTIES

If, on the basis of the data and information assembled as a result of the above-mentioned investigation, it is believed that the royalties applied to Government procurement are unreasonable or excessive, a "notice" as provided in section 1 of the act is issued and sent to all interested licensors and licensees by registered mail. Such notice provides, in effect, that no further royalties shall be paid by any licensee to any licensor until the royalty adjustment proceeding is concluded either by "order" or settlement. The notice also provides for a hearing if requested.

Irrespective of whether or not a notice has been issued, it has always been the practice of the Department of Defense to encourage voluntary settlements and to afford patent owners every opportunity to reach an amicable settlement prior to a formal hearing under the act.

In this connection, it should be pointed out that during World War II it was the general practice not to issue a notice until full opportunity for negotiating a settlement had been exhausted. This practice was based upon the assumption that a notice might adversely affect an amicable settlement. As a result of such practice, royalties in many instances were paid over to licensors which then could not be reached under the act. Experience in operating under the Royalty Adjustment Act in the latter stages of World War II and at the present time appears to show that patent owners do not object to a notice so long as they can informally present and discuss their case prior to a formal hearing and, therefore, the better procedure under the act is to issue a notice and then proceed with informal discussions relative to an amicable settlement.

As a result of such discussions, for example, the licensor and licensee may enter into an agreement under the terms of which the royalties to be charged or chargeable against Government procurement may be reduced to a rate or amount satisfactory to the Government; licensee and the Government under the terms of which the royalties, either as to rate or amount, may be reduced insofar as Government procurement is concerned.

If a voluntary settlement cannot be obtained, the matter is referred to one of the aforementioned Boards for formal action under the act. If a hearing has been requested, either party may present in writing or in person any facts or circumstances which may in their opinion, have a bearing upon the rates or amounts of royalties, if any, to be determined, fixed and specified by the Board. This hearing is formal

in character in that a transcript of the proceeding is made and recorded, but informal in procedure in that strict rules of evidence are not applied, as the purpose of the hearing is to place before the Board a complete picture of all the factors involved in order that an equitable determination of the question may be made.

At any time during the hearing or after the conclusion thereof the licensor or the Board may present a proposal for settlement. If such proposal is accepted, the matter is ended. If any such proposal is refused, or no proposal is made, the Board proceeds to issue an order under the act. However, even after the issuance of such order, and up to the time that a suit, if any, is instituted by the licensor, the matter can still be settled by an agreement mutually satisfactory to all concerned.

COORDINATION BETWEEN THE SERVICES

In order to avoid duplication of work in the services and unnecessary burden on Government contractors or licensors, it is customary to forward to other agencies which appear to have procurement of the item under consideration, a copy of any requests to a licensor or licensee for information. Each agency thereupon checks its own procurement but will not write letters out to industry without checking with the originating agency.

In the Army clearance for investigation by the various technical services must be obtained from the Office of the Judge Advocate General. In view of the fact that royalty adjustment matters are concentrated in the Office of Naval Research of the Navy and in the Air Materiel Command of the Air Force, such clearance is not required.

If interdepartmental procurement is involved, only one agency of the Government takes action, other agencies being fully informed of the progress of the case and being invited to discussions in which they may be interested. If a proposed agreement is reached by the cognizant agency, concurrence with other agencies of the Government is obtained prior to any formalization. Under the existing law, however, each Department or agency must issue its own notices and orders. Orders, however, are often joint and in any event are coordinated with the other agencies.

The manner in which coordinated action is effectuated may be best explained by illustration as follows:

Assume that the two services concerned are the Navy and the Air Force, and that, as between them, the Navy has a predominant interest in the matter by reason of its larger procurement. In such an event the Navy would be assigned action responsibility, namely, it would undertake to make a full investigation of the royalty payments involved, advising the Air Force as to the progress and results of such investigation.

Again, the Navy would, in the hypothetical situation presented, be the service that would arrange for any conference which the licensor and licensee may desire for negotiation of the royalty question, and would advise of, and invite the attendance of a representative of the Air Force at such conference.

If as a result of such joint conference a basis for amicable settlement is arrived at, the Navy, with the advice and concurrence of the Air Force, prepares a settlement agreement and obtains execution thereof. On the other hand, if it be found to be, at least for the pres-

ent, impossible to arrive at an amicable settlement of the royalty issue, then the matter of a Board hearing is involved. Such a hearing would be before members of both the Navy and Air Force Royalty Aljustment Boards, namely, the Boards of both services would sit concurrently in order to avoid two separate hearings, and joint or concurrent orders would be issued.

The number of persons in all services engaged full time in administering the act: Army, 4; Navy, 2; Air Force, 1; making a grand total of 7. These figures include professional personnel but do not include part-time clerical assistance.

FACTORS CONSIDERED IN DETERMINING FAIR AND JUST ROYALTY RATE

In determining what are fair and just rates and amounts of royalties payable for an invention, such factors as the following are taken into account:

The condition of defense production.

The production and use of the invention prior to any increase due to expanded defense procurement, including any established royalty rate; the volume on which royalty was paid; the yearly aggregate royalty paid; and the circumstances under which the licensing and the establishment of the royalty rate occurred.

The character of the invention and any patent protection therefor, the value of its contribution to the art in which it is used, and the character and expense of research and development that have been devoted to the invention.

The extent of use and proposed use of the invention by other departments or agencies of the Government and the amounts of royalties involved in the aggregate in such use.

All other considerations which are ordinarily and properly taken into account in determining fair and just royalties or which appear to be appropriate to the particular case.

In making determinations of fair and just royalties, all information necessary to a sound determination is sought, and the licensor and licensee given every opportunity to develop and present whatever informaton is available to them and which either or both may consider pertinent to the determination.

WHAT IS MEANT BY "NORMAL PRODUCTION PERIOD"

By "normal production period" is meant generally a period, during which the volume of production is dictated principally by the commercial market with no direct or immediate connection with the national defense, for example the period from about January 1, 1946, up to mid-1950.

Constitutionality of Original Act

The Supreme Court has never ruled directly on the constitutionality of the Royalty Adjustment Act, although that question was presented to the Court in each of two cases.

In one of these cases, *Timkin-Detroit Axle Company* v. *Alma Motor Company* (CAA 3. 329 U. A. 129, 71USPQ 254, 1946), in which the constitutionality of the act was challenged, a writ of certiorari was

granted; however, the Court remanded the case to the appellate court on other grounds without deciding the constitutional question.

In the other of these cases, *Coffman* v. *Federal Laboratories, Inc.* (CAA 3, 171 F (2) 94, 79 USPQ 276), in which the constitutionality of the act was also challenged, the Supreme Court denied certiorari (336 U. S. 913, 80 USPQ 600, 1949).

The Court of Claims has also sustained the constitutionality of the act in the case of *Coffman* v. *United States* (89 USPQ 276, 1951), which cited and followed the opinion of the court of appeals in the before-mentioned case of *Coffman* v. *Federal Laboratories, Inc.*

REASON FOR UPHOLDING CONSTITUTIONALITY OF THE ACT

In each of the cited cases the constitutionality of the act was sustained on the ground that the act is a valid "exercise of the power of eminent domain in aid of the war power in the patent field."

CONSTITUTIONALITY OF PROPOSED EXTENSION OF ACT

The constitutionality of the act if extended, as is now under consideration by the Congress, may be sustained, it is believed, upon the ground that the authority of Congress to exercise its war power does not end with a cessation of hostilities or a termination of a war, and that the war power includes the power to remedy evils arising from wartime conditions and to cope with current conditions arising and continuing during a national emergency.

In the report of the House committee with respect to the continuation of the Royalty Adjustment Act to April 1 1953, Public Law 450, see House Report No. 2041, 82d Congress, 2d session, page 25, Congress recognized that an emergency still exists and that under the circumstances an owner of a licensed invention utilized by the Government should receive only what is reasonable compensation. For analogy see *Woods* v. *Miller et al* (333 U. S. 138), *Woods* v. *Richardson* (CCA7–1949, 174 F. 2d 617), *United States* v. *Ericson* (102 F. Supp. 376), and *United States* v. *Certain Parcels of Land* (102 F. Supp. 695), holding such legislation as the Housing and Rent Act of 1947, the Rent Control and the Defense Production Acts of 1950, superseding similar preceding Federal laws which were concededly exercises of the war power, to be constitutional.

SUITS UNDER THE ACT—"TRIAL DE NOVO" OR "APPEAL"

Mr. Hayward Brown, Chief, Patents Section, Civil Division, Department of Justice, who is in charge of defending all suits brought in the Court of Claims under section 2 of the act has advised—

that in the few cases so far brought in the Court of Claims under such act the court has approached the matter as being in the nature of an appeal from the administrative action of the Government departments or agencies concerned. Both the claimant and the Government, by the Department of Justice, however, may introduce new defenses. To this extent, therefore, it is in the nature of a trial de novo. It is, accordingly, his opinion that a suit under section 2 of the Royalty Adjustment Act may be a mixed action, being in the nature of a review of agency administrative action, with elements of a trial de novo.

Now, I have some statistics on operations under the act for the period July 1, 1950, to February 1, 1953.

There were a total of 70 cases currently under investigation at that time; Army, 29; Navy, 22; Air Force, 19.

There were a total of 22 statutory notices issued: Army, 9; Navy, 3; Air Force, 10. In one case the Navy and Air Force issued identical notices. Possibly the Army and Air Force also issued identical notices covering the same licensees and licensors.

There were no orders issued by any of the services.

A total of 17 royalty adjustment agreements were executed: Army, 8; Navy, 0; Air Force, 9.

The estimated savings which have been made under cases which arose during the period July 1, 1950, to February 1, 1953, were: Army, $1,985,749; Navy, $320,682; Air Force, $38,700; making a total of $2,345,131.

The total amount of actual cash refunds during the same period under all outstanding agreements and orders was: Army, $59,488.34; Navy, $819,747.33; Air Force, $637,170.21; total, $1,516,405.88. Also there is $27,232.63 in Navy suspense account.

The estimated amount of royalties withheld by notices was: Army, $1,064,251; Navy, $350,000; Air Force, $800,000; otal $2,214,251.

EXAMPLES OF CASES OF UNREASONABLE OR EXCESSIVE ROYALTIES

In one case in which notices have been issued royalties totaling $840,894.15 are payable under current contracts. There are 2 licensors involved, the royalty rate to the 1 licensor being 10 percent and the rate to the other licensor of 4½ for a total of 14½ percent of sales. Both royalties accrue under the same inventions covered by one issued patent and two pending applications.

Royalties accruing at the 10 percent rate are as follows: It is only an estimate for 1953, naturally.

Year	Government	Non-Government	Total
1947	$462.00	$12,256.79	$12,718.81
1948	2,046.14	18,160.09	20,206.23
1949	32,431.17	28,646.45	61,077.62
1950	2,515.59	27,302.51	29,818.10
1951	43,688.11	39,842.66	83,530.77
1952	107,751.04	39,186.50	146,937.54
1953	400,000.00		400,000.00

As a matter of interest in this case, the total royalties of 14½ percent were more than the contractor licensee's profits which were at the rate of 12 percent.

Mr. CRUMPACKER. Thank you very much.

The next witness is Mr. Lanham.

Mr. LANHAM. Mr. Chairman, in view of the fact that there are a number of witnesses from out of the city, and that I am here all of the the time and at your disposal, I would like to ask, especially inasmuch as I am appearing in opposition to these measures, that those witnesses be given priority in the matter of hearing.

Mr. CRUMPACKER. Very well.

The next witness will be Mr. Francis W. Parker, Jr., representing the Patent Law Association of Chicago and the Chicago Bar Association.

STATEMENT OF FRANCIS W. PARKER, JR., REPRESENTING THE PATENT LAW ASSOCIATION OF CHICAGO AND THE CHICAGO BAR ASSOCIATION

Mr. PARKER. Mr. Chairman and gentlemen of the committee, I am Francis W. Parker, Jr., and my office is at 8 South Michigan, Chicago, Ill. I reside at 1850 Ridge Road, Highland Park, Ill.

I am here on behalf of the Chicago Patent Law Association and the Chicago Bar Association in opposition to H. R. 2560.

I was born in 1886, educated in this country and abroad, graduating from the University of Chicago, B. S. 1907. I studied engineering at Cornell University, Ithaca, N. Y., and law at Northwestern University and University of Chicago. I was admitted to the bar of the State of Illinois in 1912 and subsequently to the United States courts including the Supreme Court.

Except for 4 years during the last war, I have been continuously engaged in the practice of patent law since 1912 with the firm of Parker and Carter, of Chicago, Ill., of which I am now senior member. This firm was organized in 1892.

I organized the legal branch of the Chicago Ordnance District in 1940, and was called to active duty there in July of 1942 as a major, was promoted in January 1943 to lieutenant colonel and in October 1945 to colonel of Ordnance, being soon thereafter assigned to the General Staff Corps. I was relieved from active duty in the summer of 1946. My status is now colonel, Honorary Reserve, retired.

While with the Chicago Ordnance District, I also served as adviser to the commanding general on patent matters. Late in 1943, I was detailed as hearings officer by the Chief of Ordnance, in connection with a case that had arisen under the Royalty Adjustment Act.

During 1943 I wrote a Manual for Settlement of Terminated Contracts which was adopted by many other of the Ordnance districts. I lectured on contract termination at such schools as Duke University, Harvard Graduate School of Business, Horton School at the University of Pennsylvania, University of Michigan, and New York University.

I was transferred to the Readjustment Division, Headquarters Armed Service Forces in Washington early in 1944. Upon reporting for duty I became Chief of the Training Branch and my staff and I trained and supervised the training of approximately 80,000 Government and contractor personnel in the settlement of terminated war contracts.

I was awarded the Legion of Merit while with the Chicago Ordnance District and an Oak Leaf Cluster to the Legion of Merit immediately after I left active service.

During my entire war service I was in close constant touch with the patent sections of the Ordnance Department, other procurement agencies, and the Office of the Under Secretary of War in charge of procurement. I participated in and was kept advised of decisions involving patents, royalties and royalty adjustments, questions on which constantly arose and required instant settlement.

It has been urged that the Royalty Adjustment Act saves money for the Government. My experience during war was to the contrary. I

negotiated or participated in the negotiations of dozens of war contracts, most of them of great size and tremendous importance. I was intimately familiar with hundreds of such contracts negotiated by officers and civilians under my direction. We found that many contractors, otherwise anxious and willing to accept Government contracts and subcontracts became much less interested when they realized that accepting a Government contract or subcontract subjected them to the possibility, perhaps probability of arbitrary changes in business relationships and patent contracts established or made before the war.

As a result, contracts were often let to contractors who did not have the benefit of patent licenses, were less efficient and produced at higher cost. Consequently, I believe the Government lost rather than gained money as a result of the existence of this act.

This situation presented the contracting officer with two choices. He could let a contract for substitute items which were not patented and were not as good or which cost more, or he could insist on the contractor delivering patented items, thus subjecting the government to danger of a multiplicity of suits.

The act, which it is now urged be extended, came into effect in 1942, during the time when I was on active duty with the Army and while, as above pointed out, it did not effectively save the Government any money, it was in our opinion even more deleterious because of the fact that it materially slowed down contract negotiations and served as a very substantial handicap in our effort to outproduce the enemy.

Negotiating a Government procurement contract presents at best a difficult, complicated, delicate problem. A multiplicity of rules, regulations, and limitations must constantly be borne in mind if a contract, fair to Government and contractor, workable and enforceable and capable of producing the needed supplies is to result. These difficulties increase as the urgency increases. We were always under intense pressure during the war years. The procurement offices were open full time 6 days a week. All of the Army officers and many of the civilians worked regularly at least one Sunday in the month. The only holiday observed was Christmas, others such as Thanksgiving Day, New Year's Day, Independence Day were working days. We were usually short handed. Had we not been compelled to spend time and effort in connection with the Royalty Adjustment Act, our work would have been greatly expedited from a time point of view alone.

However, the existence of this act and the perils it offered to the contractor resulted in slowing up his work and furnished a constant source of irritation, misunderstanding and delay.

All the difficulties that we faced and had to compete with in a wartime economy are equally present in a peacetime economy. It is my firm opinion that the sooner the Royalty Adjustment Act is terminated, the better it will be both for Government and contractor.

When, in the years preceding World War II, the Chief of the Chicago Ordnance District, Col., now Gen. Donald Armstrong, requested Reserve officers assigned to that district to assist in persuading prospective war contractors to accept educational orders, we were frequently laughed out of the office of our friends or clients with the statement that because of the treatment the contractor had received during and after World War I, it was standard policy to take no Government contracts.

After we got into the war, this attitude gradually changed. The contractors became enthusiastic as were other patriotic Americans in the prosecution of the war but the unfair treatments that they had received or at least thought they had received, frequently rankled and the Royalty Adjustment Act was frequently thrown up to me and other Government representatives as just another example of the unreasonable arbitrary and unfair treatment contractors received at the hands of Government.

I well remember one case where I discussed this act with a prospective customer and his attorney. They pointed out that royalty payments were merely rent for the right to use an intangible thing and that if it was fair and reasonable for the Chief of the Chicago Ordnance District to dictate a reduction in rent of the patent rights, it would be equally fair for him to dictate to the owners of the First National Bank Building where our offices were, an arbitrary reduction of the rent we paid for the premises we occupied during the war. It was very hard, try as we would, to find a really effective answer to such a position.

Mr. CRUMPACKER. Could you give me any estimate as to what percentage, roughly, of the patents involved in these adjustments were corporation-owned?

Mr. PARKER. Only an educated guess.

Mr. CRUMPACKER. That is all right.

Mr. PARKER. I would say 50–50, but I am not at all sure because we never, in our consideration, we never raised any question as to whether the patent belongs to Mr. Jones or the Jones Corp.

Mr. CRUMPACKER. Do you feel that the estimate given here that there was a saving of half a billion dollars would be anywhere near accurate?

Mr. PARKER. I think it is grotesque.

Mr. CRUMPACKER. What would you estimate it at?

Mr. PARKER. I would say there was none. I do not believe there was any real saving. I think it is a saving on the assumption that as between no effort to reduce royalties and the compelling the reduction of royalties by force, there would be a saving. I think any saving that was accomplished by virtue of the force given by the law would have been equally well accomplished much more effectively so far as the overall war production was concerned by negotiations. I never found, and I am sure that it was the rarest thing in the world for our negotiators, both in the Chicago Ordnance District and, by the way, we had 7,500 people in that district at the Battle of the Bulge, and did a pretty good job—so I was told when I reported for duty in Washington. I would say that we would have accomplished just the same, just as much of a saving without the law and we would have had much less friction and difficulties with the contractors.

Mr. TAYLOR. Without regard to the saving angle of this, Mr. Parker, would you say that operating under the act did inspire the production of more materiel for war?

Mr. PARKER. I think it was a definite handicap.

Mr. TAYLOR. In what respect?

Mr. PARKER. Because, from our point of view, we had to spend a great deal of time negotiating these contracts. If we had not had to worry about the act, if the contractor had not had to worry about

the act, we would have been able to come to a meeting with the contractor more readily than we could under the pressure of the act.

Mr. TAYLOR. You mean that the contractor had to worry about the ultimate price that he would have to charge for completion of his work?

Mr. PARKER. He had to worry about that; yes, sir.

Mr. TAYLOR. I take it from the last portion of your statement in which you cite, as an example, the fact that the Government had arbitrarily reduced the rent on a bank building—I concluded from that statement of yours that it is your opinion it would be unconstitutional for the Government under such circumstances as exist in this country today to reduce the rent on the First National Bank Building.

Mr. PARKER. I am not a constitutional lawyer. I have some doubt about that.

Mr. TAYLOR. You have a very enviable background. Have you made a study of some of these cases that have been brought into the courts where this question as to the constitutionality of this act was at issue.

Mr. PARKER. I am a patent lawyer and I have not made a study of constitutional matters.

Mr. TAYLOR. Would you say, even from your cursory examination of patent laws that exist today that when a person is invested with a patent he is invested with a right which should not be infringed upon?

Mr. PARKER. I think my answer to that is this: the only thing that we have that originates in the mind of some individual is the invention which is protected by the patent right. All other property originates somewhere else. If I buy a house, somebody built it; if I buy a piece of land, the land was there before I bought it. If I buy a piece of machinery, somebody made it. If I build a house, I buy the materials and I assemble it in the conventional way. Invention is the only thing where somebody has made something exist that did not exist before, and as I see the purpose of the patent law, it is to persuade that inventor to make his invention available for the benefit of the public and the rent that he gets is his reward which keeps him from dying with that thing locked up in his mind.

Mr. TAYLOR. In that regard, is this your position: that that reward should not be imposed upon or in anywise restricted unless there was some drastic emergency which would permit the Government to step in and say, "We must in some manner or other take over your patent right and do with it as we see fit to do with it in order to cope with the emergency that exists"?

Mr. PARKER. That is right; and we have that provision in the—we have that provision in the War Powers Act quite aside from this adjustment act, Royalty Adjustment Act.

Mr. TAYLOR. Is it also your position that at the present time legislation of this character would be unconstitutional because no such emergency as was contemplated in the original act exists in this country today?

Mr. PARKER. Well, again my feeling is that it probably should be unconstitutional but I do not know. I am not a constitutional lawyer.

Mr. TAYLOR. That is all, Mr. Chairman.

Mr. FINE. What standards are employed to determine what would be a reasonable figure? How much production is required to make it unreasonable? What standards do they set along those lines?

Mr. PARKER. There is not any standard that I know of and that is one of the troubles with this act. Every procurement agency is in a position under this act to set whatever standard they please; and there is no review of that standard. The Secretary of this Department thinks that he does not like patents and he thinks nobody ought to get any patent royalties so he can set it at zero if he wants to. Somebody else thinks that 5 percent is too much and he can set it at 1 percent; and somebody else thinks that this inventor is making too much money.

How much is too much money?

Who knows?

There is not any rule or any measuring stick in the act and there was not any measuring stick available to anybody enforcing this act to tell whether this contractor or this patent owner ought to have $2 million a year, or 2 cents a year. Maybe he spent $100,000 or $200,000 or $300,000 developing something and that is all gone—that is water over the dam—and now he is getting a substantial amount of royalties every year. Shall we say that the Secretary who imposes this regulation under the statute is drawing $25,000 a year and the patent owner is making, is drawing a royalty of $100,000. He is perfectly sure that $100,000 is too much for anybody to get and so, arbitrarily, without any measuring stick or any control, decides that the royalty ought to be $25,000; and so he has the power to fix that royalty and the inventor's only recourse is to sue the United States.

Mr. FINE. I gather from what you said that there is not one agency which makes the determination, but each procurement agency makes it for itself.

Mr. PARKER. That is my understanding.

Mr. CRUMPACKER. Did you wish to have this resolution of the board of managers of the Chicago Bar Association entered in the record?

Mr. PARKER. I would like it very much. The Chicago Bar Association has two resolutions, one dated March 20, 1953 and the other one dated April 16, 1953. The first one was forwarded to this committee, and it reads:

Resolved, That the Chicago Bar Association strongly disapproves the enactment into law of H. R. 2560, a bill to provide for the extension until the termination of the national emergency of Public Law 768, 77th Congress, chapter 634, 2d session, approved October 31, 1942; 56 Statute 1013 entitled "An act to provide for adjusting royalties for the use of inventions for the benefit of the United States, in aid of the prosecution of the war, and for other purposes," as amended October 31, 1951, chapter 655, section 54, 65 Statute 728.

The committee also approved the following comments:

The purpose of this bill is to continue in force the Royalty Adjustment Act of 1942, which expires on April 1, 1953, until the end of the national emergency as declared by the President, which is an indefinite period of time. This bill is also intended to bridge the gap between the expiration of the wartime Royalty Adjustment Act and such time as it may be possible for the proponents of royalty adjustment to secure the enactment into law of permanent royalty adjustment legislation such as was presented to the 82d Congress in H. R. 2257, which last year was disapproved by the committee on patents, trade-marks, and trade practices, and by the board of managers of the Chicago Bar Association. There

is pending at the present time a bill, H. R. 401, which is substantially the same as disapproved bill H. R. 2257, 82d Congress.

We do not believe that there has been or is likely to be any real collusion between manufacturers and inventors to bilk the Government out of royalties in excess of those which are usually obtained in industry. We think that each inventor is entitled to a fair reward for the fruits of his labors and, if it should happen that an increase in manufacturing of a particular product because of Government orders brings an inventor a larger income than perhaps he had originally anticipated, he should not be denied this additional income because his invention is being used and should be used only with his permission.

It is our opinion that a royalty arrived at by bargaining between the parties is much more likely to represent a fair royalty than is one arbitrarily set by a Government administrator who may not have adequate experience or information to recognize the fairness of the returns to patent owners. The present law interferes with the right and freedom of contract and is an invasion of the sanctity of contracts which should not be continued in the absence of an actual state of war declared by Congress.

The present law has given the different agencies of the Government, particularly those within the Department of Defense, an opportunity to exercise unreasonable, arbitrary, and dictatorial control over the use of inventions which have been embodied in products ordered by the Government.

It might be argued by the proponents of the proposed bill that if it is not extended the Government of the United States will be hampered or prevented from obtaining products involving patented inventions. Such a contention is without merit. The Government of the United States can obtain any product including those covered by or manufactured by the use of patented inventions from any source without the permission of the patent owner or one licensed by the patent owner. This was the purpose of title 28, section 1498, of the United States Code which reads as follows:

"Whenever an invention described in and covered by a patent of the United States is used or manufactured by or for the United States without license of the owner thereof or lawful right to use or manufacture the same, the owner's remedy shall be by action against the United States in the Court of Claims for the recovery of his reasonable and entire compensation for such use and manufacture.

"For the purposes of this section, the use or manufacture of an invention described in and covered by a patent of the United States by a contractor, a subcontractor, or any person, firm, or corporation for the Government and with the authorization or consent of the Government, shall be construed as use or manufacture for the United States.

"The court shall not award compensation under this section if the claim is based on the use or manufacture by or for the United States of any article owned, leased, used by, or in the possession of the United States prior to July 1, 1918.

"This section shall not confer a right of action on any patentee who, when he makes such a claim, is in the employment or service of the United States, or any assignee of such patentee, and shall not apply to any device discovered or invented by an employee during the time of such employment or service. (As amended May 24, 1949, c. 139, sec. 87, 63 Stat. 102; October 31, 1951, c. 655, sec. 50 (c), 65 Stat. 727.)"

This statute was passed to permit the Government to obtain any supplies it desires. If a patent owner believes that the use of such supplies by or for the Government infringes an unexpired United States patent, the patent owner's sole remedy shall be a suit in the Court of Claims to recover reasonable compensation for such use and manufacture. The courts have construed this statute to take away from the patent owner the right to maintain an action or secure an injunction against a supplier to the Government.

The resolution dated April 16, 1953, is somewhat shorter. It reads:

Resolved, That the Chicago Bar Association strongly disapproves the enactment into law of either H. R. 2560 or S. 1235, bills to provide for the extension until the termination of the national emergency of Public Law 768, 77th Congress, chapter 634, 2d session, approved October 31, 1942; 56 Statutes 1013 entitled "An act to provide for adjusting royalties for the use of inventions for the benefit of the United States, in aid of prosecution of the war, and for other purposes" as amended October 31, 1951, chapter 655, section 54, 65 Statutes 728: Be it further

Resolved, That a copy of the foregoing resolution be transmitted to the appropriate committees of Congress.

May I say that the bar association will, although they have not yet formally done so, adopt a similar resolution in opposition to H. R. 401.

Mr. CRUMPACKER. Thank you, Mr. Parker.

The next witness is Mr. Armand Cyr.

STATEMENT OF ARMAND CYR, DIRECTOR, LEGISLATIVE RESEARCH, NATIONAL PATENT COUNCIL

Mr. CYR. My name is Armand Cyr. I am director of legislative research for the National Patent Council, Gary, Ind., a nonprofit organization of smaller manufacturers dedicated to the defense and enhancement of understanding and appreciation of our American patent system.

I am a patent lawyer and, during the last war, was in charge of the patent section of the Chicago Ordnance District. My duties included the administration of the wartime Royalty Adjustment Act in the field. This included contacts and negotiations with patent owners and contractors doing business with the Government through the Chicago Ordnance District. Because of this experience in the operation of the wartime Royalty Adjustment Act, John W. Anderson, president of National Patent Council, suggested that I appear before your committee and express my views regarding the pending royalty adjustment bills, H. R. 401 and H. R. 2560.

I realize this hearing has been scheduled on H. R. 2560, which proposes an extension of the wartime Royalty Adjustment Act, for the duration of the national emergency, as proclaimed by the President on December 16, 1950, and 6 months thereafter. However, while the following remarks are addressed particularly to H. R. 2560, it will be found that they are applicable to H. R. 401, which is also before this committee, and which provides for the enactment of a permanent patent Royalty Adjustment Act.

The wartime Royalty Adjustment Act was designed primarily to curtail or eliminate so-called war profiteering by owners of patented or unpatented inventions used in the production of the war materiel purchased by the Government. The act was administered largely on the questionable theory that the competitively honored added value embedded in the product by the patented invention should be depreciated by the Government if it seemed to someone in Government to earn, at commercially honored royalty rates, more money than the inventor or his assignee should have.

H. R. 401 would make the wartime Royalty Adjustment Act a permanent statute, and continue to give the head of each Government procurement department or agency the right to investigate patent royalty agreements, when royalty is included as an item of cost in a Government contract, and to revise the royalty rate stipulated in those agreements to suit his own judgment. Enactment of H. R. 2560 would accomplish substantially the same result, since the duration of the national emergency and 6 months thereafter might result in some degree of permanency.

During the last war, I personally investigated from 50 to 100 cases involving royalty charges in Government contracts. During those investigations and subsequent negotiations for royalty adjustment, whenever deemed proper, I refrained from referring to the Royalty

Adjustment Act or the possible issuance of an order under that act, because I didn't feel then—and I don't feel now—that the Government should enter negotiations for adjustment of royalties with a club in its hand.

However, I have witnessed many instances where others having similar authority did not hesitate to use all the force and effect of the wartime act in demanding a curtailment of the royalty charged the Government. Sometimes the negotiations would open with a statement made by an officer representing the Government, explaining the wartime Royalty Adjustment Act and calling specific attention to the power the Government had to cut the royalties down to nothing if it so desired. In those instances, the patent owner was really put on the spot because he knew that, if he did not accept whatever proposal was made by the Government, he would face a long, hard fight in the Court of Claims to recover what he felt was his just royalty. That is where the danger lies in this legislation.

When I first reported for duty with the Chicago Ordnance District, I was assigned to the Patent Section, Legal Division, to replace a colonel who had had a great deal of experience in the practice of patent law and in dealing with companies, corporations, and individual patent owners. I recall that when I took over this job the colonel told me I should remember never to kick the Government contractor or the patent owner around because we needed both of them in the struggle to win the war. I soon came to realize that this was very sound advice and the longer I worked on the job with the Ordnance Department the more I respected the colonel's views.

As I mentioned heretofore, I had many contacts with Government contractors and patent owners throughout the Chicago Ordnance District which covered some 4 or 5 States in the Midwest. Whenever a contractor's proposal having a royalty or license fee included as an item of cost came in to the Chicago Ordnance District, the Procurement Division immediately notified me of this charge. If the royalty amounted to $5,000 or more, my instructions were to investigate and determine the basis for such payment. This I did by contacting the contractor and examining any license agreement he had with the patent owner, who in many instances was an engineer or other employee of the contractor. After noting pertinent facts about the agreement, I reported to the Chief of the Patent Department of Ordnance in the Pentagon. Usually, the next step was a memo issued by the Chief of the Patent Department in the Pentagon listing the patent owner's royalty revenue for the past 5 years. Where they obtained these figures, I don't know, but, in cases that were pursued further, the memo usually showed a substantial increase in revenues after the start of the war as compared to lower figures in 1938, 1939, and 1940. The instructions accompanying the figures were that an effort be made by our office to reduce the royalties paid by the Government to this patent owner because it was probable that the increased revenue was attributable to extensive Government purchase of the patented item.

At this point, I arranged a conference with the patent owner and the Government contractor who was obligated to pay the royalties. In such a conference, I took the position that a negotiator for a large company would assume, and endeavored to negotiate for a reduction in royalties paid by the Government solely on the basis that, had the war not come along, his royalty would have remained substantially at the

lower figures of 1938, 1939, and 1940. I was willing to concede that even if his royalties increased by a very large percentage in each of the years 1941, 1942, and 1943 over the 3 previous years, the patent owner might still be entitled to the increase through the normal growth and expansion of the licensee's commercial production of the patented item. I also took into consideration, especially in 1945 after the defeat of Germany, the fact that, since the Government was purchasing large quantities of the patented item, there was a strong possibility that those same items might find their way into the commercial market at the close of the war and thus flood the market for perhaps a year or more. Other factors that were given consideration during these negotiations were the potential commercial aspects of the invention as distinguished from its purely defense use. I do not recall a single instance where I found it necessary to refer to the Royalty Adjustment Act, or Public Law 768, as it was then known.

The records will show that many cases out of the Chicago Ordnance District were settled to the benefit of the Government and that, in cases where settlement was not effected to the extent desired by the officers in Washington, a complete report was made, bringing out the extenuating circumstances that would have made it inequitable to effect a further reduction in the royalties.

It may seem strange to this committee that I here testify that although Public Law 768 gave the administrators thereof the right to effect royalty adjustments in each and every case, regardless of extenuating circumstances or other equitable considerations, I did not use that law. The explanation is simple. The administration of that law from the Pentagon is quite different from its administration in the field, in direct contact with the patent owner and Government contractor. For example, in Chicago Ordnance District, the Procurement Division kept urging contractors constantly for more and more production, and welcomed every new device or item that would help expedite the termination of the war. Government procurement men all over the country had a deep respect for the patent owner and the Government contractor, and Lord help a junior officer, as I was, who would in any way antagonize, disrupt, or interfere with this friendly relationship between the Government contractor or patent owner and the Procurement Division—a relationship that resulted in substantial contributions and ultimate success in the war.

From my experience in 3 years of royalty adjustment negotiations in the field, I must say that the danger in this legislation is not from the men in the field, but rather with those officials in Washington whose sole responsibility is to reduce as much as possible all royalties paid by the Government. People in the Pentagon seldom if ever come in contact with the contractor or the patent owner, but they do possess this big club in the form of Public Law 768 and constantly urge their field men to use it. Had I followed those instructions to the letter, I can assure you that Chicago Ordnance District's splendid record of production and delivery of war materiel would not have been achieved.

Most of our trouble in the field came from those officers in Washington who felt that whatever reduction we were able to obtain in royalty payments made by the Government was always insufficient and that for one reason or another, such as limited value of the invention, questionable validity, and so forth, Public Law 768 should

be invoked to effect further reduction. When this situation came up, as it did on many occasions, some officer from Detroit or Washington came out to Chicago and a conference was arranged with the patent owner and the contractor who was paying the royalty.

Those conferences often left a bad taste in my mouth because of the way the contractor of the patent owner was treated. Usually, the first statement of the Washington or Detroit officer was an explanation of what the patent owner would have to do under Public Law 768 if he refused to accept whatever offer was made to him for a further reduction of his royalties.

Following these conferences, I invariably got a call from the Procurement Division, complaining that some contractor was rather lukewarm about accepting any further Government contracts. The contractor had made it plain that he felt the Government was giving him and his employee-inventor a rough deal. In these conferences, I often found myself agreeing with the contractor and the patent owner rather than with the Detroit or Washington officer, because I appreciated the reasonableness of their royalty figures. I knew firsthand how much they had helped meet the demand for war materiel and how badly we would need their continued cooperation, if we were to win the war. However, in many of these cases, justice was sacrificed on the altar of patriotism.

Based upon my 3 years' experience in the field of negotiating patent royalty adjustments in connection with Government contracts, I cannot for the life of me see the necessity for further extension of the Royalty Adjustment Act or enactment of a permanent Royalty Adjustment Act, such as is proposed in H. R. 2560 and H. R. 401, respectively. In some cases during wartime such a law might possibly be useful but I cannot conceive of an instance where such a law could be necessary in peacetime. I have shown how the administration of such a law, even in wartime, can do more to disrupt production and supply of needed war materiel than strikes, labor or material shortages, and so forth, and obviously the same administration of that law in peacetime would make it increasingly difficult for the Government to obtain needed materials from established plants. It most certainly would tend to close the door to the Government's use of new inventions and improvements.

I am convinced that, if the Government agencies desiring this legislation will send their men out to negotiate patent royalty adjustments, they can accomplish the desired results without having a club in their hands, such as they have in the Royalty Adjustment Act. Why should there be a difference between their negotiations for what they consider a fair and reasonable royalty and those of large corporations like Chrysler, General Motors, and General Electric, who negotiate royalty agreements almost every day with patent owners who have invented and developed items that those corporations desire to place on the market? They do not have such a club in their hands when they negotiate with the patent owner and yet they are successful in arriving at a royalty they consider reasonable. Why should the Government furnish its negotiators with this club?

The use of a club in negotiations resembles too much the methods of Hitler's Gestapo or Russia's NKVD. In other words, the Gestapo and the NKVD might come into your office and say, "This is what we want." The man with the Royalty Adjustment Act in his hands like-

wise comes into your office and says, "This is what we want—you reduce your royalties by so much or take your chances in a long, hard, expensive fight against the Government in the Court of Claims or the District Courts." This is not negotiation.

I must add that, if you continue to give Government agencies this club, you are giving impetus to a tendency to place in the hands of the Government more and more power. You are placing in the hands of bureaucrats a club that will deter real negotiation as the term is commonly understood, and you are encouraging litigation and discouraging war or defense production. The answer is simple. If the man in charge of the administration of this act wanted to go out and negotiate a royalty adjustment on a Government contract, he could do so, and he would not need the Royalty Adjustment Act in order to accomplish his purpose. On the other hand, being in charge of the Royalty Adjustment Act, his job is to administer that act, and the only way he can do it is to invoke the provisions thereof, which often deprive the patent owner of his fair and just royalties without even a fair and impartial hearing.

The following is what I believe to be a typical example of the harm that can come from the administration of the Royalty Adjustment Act, whether in wartime or in peacetime. Let us assume that Mr. Jones is a small manufacturer producing an item that has commercial use as well as use in the national defense, and one of his employees, named Smith, is a prolific inventor. Jones enters into an agreement with Smith whereby Jones will receive the exclusive right to manufacture, use, and sell any of Smith's inventions, in return for a royalty of 5 percent of the sales or cost price. The contract is reasonable and fair to both parties.

Three or four years later, the Government starts buying this product, and the head of the Government department purchasing the item notes a royalty payment to Smith included in the cost of the product. Investigation is made into the basis upon which Jones pays Smith this royalty. The Government agent may not have had any experience in negotiating patent royalty agreements, and/or may be absolutely unfamiliar with royalty rates on items in that industry. He sees nothing wrong with the agreement as such, but thinks the royalty rate should be 2 percent instead of 5 percent.

There is nothing in the wartime measure which Government agencies now seek to extend, nor is there anything in the proposed permanent legislation, that makes it necessary for the Government agent to say why he feels that 2 percent is sufficient and that 5 percent is too much. All that is necessary is that, in his own mind, the royalties are "believed to be unreasonable or excessive."

The agent then issues a notice, or recommends to his chief that a notice be issued, to Mr. Jones and to Mr. Smith, advising them that the royalty of 5 percent included as an item of cost in Mr. Jones' contract with the Government is excessive. Upon receipt of this notice, Jones must commence accumulating and impounding the 5 percent royalty which he collects under his contract with the Government, and cannot pay Smith 1 cent of that royalty, even though his agreement with Smith specifically obligates him to pay such royalty on all products manufactured and sold by Jones and embodying the Smith invention.

Thus, the Government is inducing the breach of a valid contract. Smith, the inventor, is the real loser in this transaction; and, in exercising his rights under the Royalty Adjustment Act, must present to the Government agency in writing or in person any facts or circumstances which tend to show that he is legitimately entitled to the 5 percent royalty. These facts and circumstances are considered by the agent who investigated the royalty agreement, and/or his superior, special board, officers, and so forth. The agent and his board of superiors, perhaps having little or no experience in matters of royalty payments on various inventions, are still of the opinion that 5 percent is unreasonable or excessive, and so an order is issued, freezing the royalties to 2 percent on all Government contracts for this item, and Smith's only remedy is to sue the Government in the Court of Claims or the district courts in an effort to recover the 3 percent royalty denied him.

I wish it were possible to appraise the real harm this typical example can do our Government. Regardless of the immediate saving effected through the use of the Royalty Adjustment Act in the above case, the Government is sure to lose in the long run. For example, if the Royalty Adjustment Act had not been invoked, the bulk of Smith's royalties, under our tax laws, would have been paid into the Treasury as tax. On the other hand, Smith might well make a most valuable and meritorious invention in the future that would be of tremendous assistance to the Government and would perhaps save the Government many thousands of dollars. Do you believe that Smith will be anxious to make his new invention available to the Government, after having been pushed around in conferences with Government agents and, later, in the courts over a period of years? The answer is obvious, and the Government is therefore the loser in the long run. A person does not go around biting the had that feeds him and profit thereby. Is there a different rule for the Government? Take away from the inventor the fair return he is entitled to for the use of his invention and you will probably lose for all time the fruits of that inventor's knowledge.

If royalty rates established originally, or anew, are obviously intended to be unfair to the Government, and are obviously unreasonably high, doubtless the Government should have some recourse besides declining to use the product. It does. Under the act of 1910 the Government has the right at any time to make or have made for its own uses any patented product and require the patent owner to resort to the Court of Claims for damages. Even under circumstances appearing to justify such action, the problem should be approached first in a true spirit of negotiation; the appeal should be to reason; and any arbitrary powers granted by law to reduce the rate of royalty should be exercised with every attempt to make a reasonable compromise and leave the producer and the inventor unresentful and with every incentive to continue to cooperate in the interests of Government.

In any event, there should be a definite limitation to the extent to which royalties may be reduced—even under conditions suggesting arbitrary action. The guiding motive should not be merely to keep an inventor from acquiring what might be considered by some to be "too much money." The larger requirements of the Government mean that the Government gets a proportionately larger benefit from

the invention. Unreasonable reduction of royalties amounts to unfair confiscation—never a stimulant to incentive.

It is my firm belief that where a royalty rate has been established in good faith in civilian production, before the Government matures its requirements for the product, that royalty rate should be recognized and paid on products made for the Government.

Some valuable guidance might be obtained by reference to royalty rates prevailing in industries which perhaps use as great or greater numbers of certain types of products than would Government. One such industry, for example, is the automotive industry. While there is considerable history of arbitrary patent policy on the part of vehicle makers, such policy has resulted in such disadvantage to the vehicle maker practicing it that, over the years, the policies have been considerably modified.

Today, while royalities of 5 percent, and even 7 percent, are recognized, and paid directly or indirectly, by vehicle makers, on large-volume products, the contribution of inventor and manufacturer has to be of a rather unusual character to justify such royalties.

On the whole, the automotive industry has come to recognize, on its largest volume products, royalties of approximately 2 percent as low enough to satisfy even a highly competitive requirement.

In some instances a reduction in royalties to as little as 1 percent has been volunteered by the manufacturer and the inventor, where incidental advantages to them seemed to justify.

The president of National Patent Council has been active for many years in the automotive industry, and it is from him that this information comes.

Reviewing the experience in the administration of the Royalty Adjustment Act that I have herein related, it should be evident to this committee that some harm to the inventor, the Government contractor, and even the Government itself will result from the administration of the Royalty Adjustment Act, whether it be in wartime or in peacetime. It is therefore hoped that the committee will weigh this fact against the questionable need for the act in true negotiations, even in those cases where adjustment of royalties has been found desirable, and will not report favorably either H. R. 2560 or H. R. 401.

Mr. CRUMPACKER. Can you give me any estimate as to the number of patents involved in these adjustments which were corporation owned? The reason I keep asking that question is that I would like to get some kind of an estimate of what percentage of them might be subject to the excess-profits tax.

Mr. CYR. I believe, Mr. Chairman, as Colonel Parker has stated a moment ago, that it probably ran about 50 percent.

Mr. CRUMPACKER. Now, this reference you made here in your statement to the act of 1910 which gives the Government the right to make or have made any patented article and leave the patent owner to the Court of Claims for compensation—does that not in substance give the Government every right which it has under this Royalty Adjustment Act except that it bypasses the administrative procedure?

Mr. CYR. That is true, Mr. Chairman. It does give all the rights that it needs. If it wants to use a patented item, go ahead and use it.

Mr. CRUMPACKER. So that even without any extension of this Royalty Adjustment Act, the Government still could, in cases where

it thought there were excess profits being earned on patents, go ahead and make the article without delay and leave it for the courts to determine what is just compensation?

Mr. CYR. Yes, that is true. They could do that. If you will recall, in the first part of my testimony I mentioned the fact that wartime Royalty Adjustment Act was set up or enacted to curtail or eliminate so-called war profiteering. That was the basis for that act when it was passed. Some people had the thought that these patents, patent owners would get rich overnight because their inventions were being used extensively by the Government.

Mr. CRUMPACKER. Do you know from your own experience of any cases where this provision of the act of 1910 has been invoked by the Government?

Mr. CYR. I do not know of any, but I am certain that there must be many cases where the Government has invoked the 1910 act.

Mr. FINE. I do not quite understand the answer you gave to the chairman on this 1910 act. Will you spell it out, please? When you say that the Government can take the patent and manufacture it, do you mean that the Government itself will manufacture it?

Mr. CYR. Have someone else manufacture for it.

Mr. FINE. All right. Are there not instances in which the Government cannot take a patent from anybody because only a specific manufacturer could manufacture the item because only that manufacturer has the right to that patented item? Is that not so, under a contract?

Mr. CYR. The manufacturer may be the only one who has the right to manufacture under the patent, but the Government can nevertheless go to someone else, have that item manufactured regardless of the patent, and leave the manufacturer or the patent owner with his remedy to sue the Government in the Court of Claims to recover whatever damages he can.

Mr. FINE. In other words, the 1910 act permits the Government to confiscate, if we can use that term—or appropriate unto itself the patent and let it out to anybody.

Mr. CYR. For its own use.

Mr. FINE. For its own use.

Would not the contractor under those circumstances under that act have a right to sue, too, a specific contractor?

Mr. CYR. You do not mean the patent owner?

Mr. FINE. I am talking about the manuafcturer.

Mr. CYR. Unless he had a license under the patent, I am not too certain on that. I know that the patent owner would have the right to sue the Government. He is the one who is harmed by it.

Mr. FINE. I am not too familiar with all the details, but what I was thinking about, you have prepared a very excellent and thorough statement, but what I am leading to is that perhaps there ought to be some middle road. You seem to indicate that some right or some jurisdiction or some power should be given to the Government to be able to negotiate these royalty contracts in case there is an unreasonable situation. You seem to say that in the earlier part of your statement where you say that they can do it in any event and I assume you were referring only to the 1910 act.

Mr. CYR. No; what I was referring to there is that the Government does not need an act in order to negotiate royalty adjustments.

If it will send its men out, talk to the patent owner and to the contractor who is making the item and paying the royalty, negotiate with them, just as you would if you were a corporation and you wanted the rights under a patent——

Mr. FINE. We cannot lose sight of the fact that the Government is not in the same position as a private manufacturer when it comes to dealing with its citizens. Either it has some sort of a club or some sort of an authority or not. If it has not any, the negotiations are very difficult.

Mr. CYR. Well, I would disagree with that for the reason that from my own experience I know that negotiation is possible. It has been accomplished without reference to the Royalty Adjustment Act. It is not needed.

Mr. FINE. Would you recommend a middle road, some sort of legislation which would make it easier for the Government and yet remove the onus, the burden from the patent owner?

Mr. CYR. I would have to assume that it is impossible for the Government to negotiate and that I cannot do at all because I am convinced that they can negotiate and they do not need any power.

Mr. FINE. Well, you see, I have a different philosophy about it because the Government official sits there. He has not any personal interest as the owner in private industry has. The owner is looking for profits. The Government agency, administrator, is not, has not the personal interest except the patriotic interest of doing his job well. So when he comes in to negotiate, the pressure, other efforts are made which are not on record all of the time, which make it more difficult to negotiate, and perhaps something ought to be written into the law, perhaps something in between, if you will, the act which you oppose and a lot of other people oppose, and the 1910 act which seems to be a pretty drastic remedy even at that.

Mr. CYR. I certainly do not know of any middle road or any middle power, if you want to use that term, that would remedy the situation. I still maintain that if a person in the Government is hired to negotiate royalty adjustments——

Mr. FINE. Don't misunderstand me; I have not made up my mind. I am merely exploring something that is troubling me. Perhaps I have not hit it as clearly as I would like to at the moment. Perhaps it will become more clear as we expound it and with the other members of the committee discussing it—I find in this Congress they come up with some very fine ideas and they are very bright men and perhaps they will be able to help on this.

Mr. TAYLOR. What I just do not get is this, and perhaps you can enlighten me, Mr. Cyr. Do these various agencies of the Government negotiate with a contractor and the owner of the patent?

Mr. CYR. Yes, sir.

Mr. TAYLOR. Is there any formula whereby all of the agencies of the Government set a figure as to what the Government would pay for use of this patent?

Mr. CYR. Yes.

Mr. FINE. Just carrying it further, if I may, Mr. Chairman, is there any instance on record where this patent owner coming into one Government agency is reduced, say, from 5 to 2, and in another agency is reduced from 5 to 3?

Mr. CYR. I do not believe that could come about for this reason: when you negotiate a royalty adjustment, the agreement, I believe, is drafted to cover all Government procurement. In other words, the license is not directed solely to, we will say, the Air Corps or Ordnance. That is my understanding, that any agreement reached by any one of the branches or agencies would inure to the benefit of all, be binding on all.

Mr. CRUMPACKER. In your opinion, is H. R. 401 any improvement over the existing law?

Mr. CYR. No, sir; none at all.

Mr. CRUMPACKER. Are there further questions of Mr. Cyr?

Mr. FINE. No, sir.

Mr. TAYLOR. I have no questions.

Mr. CRUMPACKER. Thank you very much, Mr. Cyr.

The next witness is Mr. W. R. Ballard, representing the National Association of Manufacturers.

STATEMENT OF W. R. BALLARD, ADVISER TO THE COMMITTEE ON PATENTS, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. BALLARD. I am William R. Ballard, a member of the New York bar and the bar of the Supreme Court, and I have had some 50 years' experience in connection with patents. I am here today representing the National Association of Manufacturers.

I am adviser to the committee on patents of the National Association of Manufacturers and I am speaking today for that association. It is a voluntary organization of more than 19,000 manufacturers, 83 percent of whose members have less than 500 employees each.

H. R. 2560 would extend the life of the Royalty Adjustment Act of 1942, a strictly wartime measure, for an indeterminate period defined only as the present declared emergency plus 6 months.

The National Association of Manufacturers is opposed to the extension for the following reasons:

The Royalty Adjustment Act proceeds upon a mistaken theory to reach an undesirable result;

The procedures set up in the act are not necessary to a proper adjustment of royalties; and

The procedures of this act violate basic principles of ethics and commercial integrity.

The Royalty Adjustment Act is designed to lower royalties payable by the Government for use of patented inventions. It is directed specifically at cases where a Government supplier is operating under a license agreement with a patentee which requires the supplier to pay the patentee royalties on the things furnished to the Government. The act permits a Government executive official to order the royalty payment eliminated or reduced to suit his own idea of what is reasonable, and requires the supplier's price to the Government to be correspondingly reduced.

The theory back of this act and its administration by the officials in charge seems to be that royalties for use of inventions by the Government should be driven down to an irreducible minimum; and that the Government's whole power and strong bargaining position should be applied to bring this about—whatever the cost in time and money.

Such a course with respect to royalties is almost the direct opposite of the wise course for the Government, as we see it.

The Government is heavily dependent upon the inventions of the citizens to keep it ahead in the development of defense material. Its policy should be to encourage such invention by providing real incentive to inventors through royalties. By such a policy, the eventual saving in lives and in money will far outweigh any amount by which royalties can be reduced under the present practice.

The correct and wise attitude for the Government to take has been expressed and approved by so able a group as the Patent Policy Review Board of the Armed Services in its report of August 12, 1952. The Board members were there considering the incentive that could flow from patent rights growing out of Government development contracts, but the principle applies with equal force to incentive which may come from royalties. On pages 22 and 24 of the report they say:

> The lifeblood of the armed services is invention when this word is used in its broadest term to mean anything which is new and useful and will improve the efficiency of the services. The value resides primarily in the invention itself.
>
> On the other hand industry is primarily interested in patentable inventions and their industrial know-how. Both of these assist industry in maintaining a competitive position.
>
> The Congressional Aviation Policy Board of the Congress stated: "To assure effective incentive to established companies to maintain efficient research, and to encourage new companies to enter the broad field of aeronautics, Government contracts should provide that the companies retain title to the inventions made under research and development contracts. Thus, companies can maintain competitive commercial positions and Government can benefit from resulting heightened incentive."

And the Board recommends that this Aviation Board's policy be applied throughout the armed services. This recommendation was made with full knowledge of the established rule of law that one who hires another to invent may, if he choose, claim full title to the invention made and the patent. The point is, of course, that the Government merely defeats itself by playing Shylock in cases where incentive is important.

It is obviously just as important to follow this wise policy with respect to royalties as it is with respect to the title to inventions coming out of Government development contracts. Experience with our patent system has shown that it provides the most powerful incentive to invention ever known when it is free to operate normally. In the field of defense it must be remembered that even one top-notch invention may save thousands of lives and millions of dollars. Yet, for the sake of saving a few dollars in royalties we have been destroying incentive which might have brought us scores of valuable inventions.

We must keep in mind that there is no formula or principle by which the fairness of a royalty can be fixed. One man may gladly pay twice what another is willing to offer. The only test is, what will the prospective licensee pay rather than go to the next best alternative. There is no reason why the Government should have a preferred position as to royalties. Even the idea of "wholesale" rate has no logical application to royalties. A man who uses 10,000 things embodying an invention presumably receives 10,000 times the benefit coming from the use of one.

The act under consideration applies to royalties that have been set by arm's length commercial bargaining and which are far more likely to represent fair value than a royalty set arbitrarily by the one who is required to pay it. If a case arises of collusion or conspiracy to defraud the Government by rigging false royalties, it can be taken care of by other provisions of existing law.

It is folly, we believe, for the Government to squander the taxpayers' money to maintain a corps of employees whose time is spent in trying to avoid royalty payments by attempting to prove invalid patents which the Government itself has granted, and in trying to prove that this or that particular royalty rate is too high.

It is our view that Government will best serve the cause of national defense and the public by dropping its existing attitude on royalties and adopting instead a practice designed to provide incentive for invention in the defense field.

Even if we assume that there might be a case where a royalty established in good faith between a supplier and a patentee might wisely and properly be reduced, the reduction by fiat of the Royalty Adjustment Act is not necessary.

Commercial concerns reach agreement on royalty rates by negotiation. The Government is in a much stronger bargaining position as to royalties than any commercial concern because the law, 28 U. S. C. 1948, enables the Government to proceed without a license to make or use the invention, or have another make or use the invention for it, if it elects to do so; and the patentee's only remedy is by suit for compensation in the Court of Claims—a slow and costly procedure.

Let us suppose that, in the case assumed, the Government's procurement officer got together with the supplier-licensee and the patentee-licensor and said to the patentee: "We have a very large order for items involving your invention but your royalty is too high. If you will reduce your royalty from 50 cents an item to 40 cents an item, we will give the order to your licensee; otherwise we shall place the order elsewhere." The result of such negotiation can hardly be in doubt. For reasons already stated, we may question the wisdom of forcing the rate down but we can hardly question the effectiveness of the Government's position for doing it.

Instead of reduction by negotiation as just described, the Royalty Adjustment Act proposed reduction by an executive fiat impairing the obligation of a contract made in good faith between two citizens.

This is not the American way of doing things. In this country, the obligation of a contract has always been regarded as inviolate in the absence of fraud. The States, which retain all powers not given to the Federal Government, are expressly prohibited by the Constitution from passing any law impairing the obligation of contracts, article 1, section 10, and Chief Justice Chase of the Supreme Court has pointed out that Congress, having only delegated powers, has no power to pass a law impairing the obligation of contracts without constitutional authorization to do so, such, for example, as is given with respect to bankruptcy. James Madison, writing in the Federalist, No. 44, stated that:

> Bills of attainder, ex post facto laws and laws impairing the obligation of contracts, are contrary to the first principles of the social compact and to every principle of sound legislation.

Daniel Webster, discussing legislative power to impair the obligation of contracts, said:

> Acts of this nature are not the exercise of a power properly legislative [and] to justify the taking away of vested rights there must be a forfeiture to adjudge upon and declare which is the proper function of the judiciary.

This was from the argument in Dartmouth College case.

We urge, therefore, that the Royalty Adjustment Act of 1942 be permitted to expire on July 1, 1953, as provided in Public Law 12, 83d Congress.

We submit that, in its place the Government should revise its policy toward royalties and patents relating to defense procurement so as to encourage rather than discourage invention in this field. To this end:

Let Government stop spending time and money trying to invalidate patents which it itself grants;

Let Government, in the absence of fraud, accept prevailing commercial royalty rates, or negotiate for a proper royalty which will provide incentive for invention in the field of defense;

We believe that the course here suggested is required by an enlightened self-interest on the part of Government—and the Defense Department in particular. Incentives will be restored by the elimination of the present penny-wise and pound-foolish policy, with eventual saving to the public in dollars, lives, and security.

Mr. CRUMPACKER. Do you think the administrative procedure that is involved in the Royalty Adjustment Act makes it substantially different from or better than the existing patent law?

Mr. BALLARD. You are referring to the 1910 law which has been mentioned here?

Mr. CRUMPACKER. Yes.

Mr. BALLARD. I think there is quite a difference. The 1910 law, as I view it, is intended as an anchor to windward in case the Government is really in a jam; it is not subject to an injunction to stop it, under a patent. That is the only difference. It is bound to pay fair price, just the same as anybody. The right way to do this thing, of course, is not under the law, to go and rush into the protection of the 1910 law, but to go to the patentee and negotiate with him and that can be and has been done.

Now, Representative Fine has suggested that perhaps we needed a middle ground law to permit that. I agree with Mr. Cyr that you do not. But section 3 (a)—section 3 alone of this Royalty Adjustment Act specifically provides that a Government official may make an agreement. If such authority is necessary, let us have it; but the right way to do this is by negotiation and where, as under the Royalty Adjustment Act, you proceed backward—the official notifies you that the royalty is excessive or that it is going to be wiped out, and then leaves you to negotiate with him, that damns the negotiation before you ever start it. Where can the patentee go from there?

If the thing is approached as Mr. Cyr has suggested it be approached, we get the right answer, in my opinion.

Mr. FINE. The section 3 that you just referred to, is that part of the permanent law?

Mr. BALLARD. It is embodied in the Royalty Adjustment Act.

Mr. FINE. H. R. 2560 would not repeal that, has no effect on that?

Mr. BALLARD. It would continue it.

Mr. FINE. That is section 3 also? It just says sections 1 and 2 as I read it. That is according to the statements, everybody seems to refer to sections 1 and 2 as expiring on July 1, 1953. What about section 3? Does that expire?

Mr. BALLARD. I do not know. I really do not know the answer to that. If section 3 remains in force, nobody is going to quarrel with it because it is just what I and what Mr. Cyr and other intelligent——

Mr. CRUMPACKER. Thank you very much, Mr. Ballard.

Mr. Walter A. Wade. Is Mr. Wade present?

(No response.)

Mr. Robert V. Morse.

STATEMENT OF ROBERT V. MORSE, PATENT ATTORNEY, ITHACA, N. Y.

Mr. MORSE. Mr. Chairman, I am going to speak very briefly and extemporaneously, so I will stand.

Mr. CRUMPACKER. Will you state your name and address and the capacity in which you appear for the record?

Mr. MORSE. I am Robert V. Morse, of Ithaca, N. Y. I am a member of the bar and a patent attorney. I am also an engineer.

I would normally, on this subject, have spoken as a patent attorney. As part of my qualifications I may say that I am a member of the American Society of Chemical Engineers, the American Bar Association, and the bar of the Supreme Court of the United States, and of the District of Columbia and the State of New York.

However, I have heard such able statements of the general policy in opposition to the extension of the act that I will just speak very briefly, for a moment, from the standpoint of the inventor. It happened that years ago I was a rather prolific inventor myself and, being in this business, have been in contact with inventors for 40 years. And I have been in contact with Government agencies.

In general, this type of restriction such as compulsory licenses or any other act of a government to coerce an inventor after a patent is granted, has historically, and in the experience of other nations, been detrimental to their progress. I think the United States is generally conceded to be far ahead of the European nations in matters of invention, and certainly in this patent system; whereas in Europe we have, say, in England and France, the inventor after he has his patent still had to, there was a possibility of being brought before some Government agency or agent to tell him how much he could get for it.

In this country, we merely have the act of 1910 which is no different from the eminent domain that exists in all law in all States, namely, that if a Government has to have some property, it can take it and you can go into court. That is a drastic thing, but it is sufficiently drastic; but the general Government official does not invoke it except in extraordinary cases and normally business can be done by negotiation. So it is.

Now, I would just like to speak now as an inventor. They are not favored by fortune. They have a hard life. Most inventors take 3 years to get a patent through the Office. It costs them a lot of money and if a man happens to get the inventive bee, it interferes with his other activities and the typical, I mean at least the very frequent

cases—I will mention a few—the inventor of the telegraph, a successful man, a portrait painter, painted the House of Representatives, Lafayette, making good money.

He happened to have the good fortune to think on a trip back from Paris that electricity can transmit messages. Ten years later he is in a Washington boarding house without a dollar to his name. He owes 2 months' rent. By a mere freak of fortune, he met a piece of good luck and ended a prosperous man. If the House of Representatives had not quit joking for the third successive time about the thing and happened to turn the clock back and passed $40,000 for that Baltimore thing, he would have died a pauper.

Lake invented the submarine. The United States Government did nothing with it. It was developed by Germany.

Maxim invented the machine gun. No support here. It was developed in Europe. He changed citizenship to Canadian before he died.

The Wrights invented the airplane. It was just by luck that the war came along and made big business for them. And it took them until the death of Langley to have the placard in the National Museum to say that they were the first inventor of the airplane. It took them 30 years to get that.

Well, the inventor starts in. He uses his own money, brains, breaks up his normal occupation. He struggles along and has a chance in a hundred, which is too high, of winning on that. But it takes many years to get through the Patent Office. Then he has to find some manufacturer and try to get the manufacturer and try to get the manufacturer sold and chances are 10 to 1 he won't.

But, in the end, suppose he surmounts all those hurdles. If it has anything to do with a Government contract, this act hangs a red flag in front of him and says, when it is all said and done, some man, some Government negotiating officer, without any judicial proceeding, will just tell you what you are going to get for it.

There was some little attempt at something like that with the idea of making compulsory licenses legal in this country. The entire, not only patent bar, but all of industry blocked that. But just the threat of that made a very substantial drop in the number of applications filed in the Patent Office. The curve just dropped down for the first time in the history of the United States.

The mere suggestion that this law might be extended either temporarily or indefinitely cannot help but make every inventor who has any hope of a Government contract feel that he is wasting his time because he has no—the incentive is just taken away from him. And there are no statistics that we can later point out on a curve what inventions would have been made and what applications would have been filed because many of these men just—but we do know that inventors are human. They are just like the rest of us. And they are as unlikely to take the risks and put in the sweat that goes into an invention as gentlemen in any other profession are likely to if in the end their hope of reward rested on the mere chance of some action of some rather casual person without any real possibility of review, except trying to sue the great Government of the United States in the Court of Claims, an act which few inventors can afford.

So, if I were young again and back in the patent game, and on the other hand could make a living as a lawyer, or running a garage or doing something else I had some talent for, and I had a wife and family

to support, and I knew that this act was standing as it is, and was going to stand, and I had some inventions as I did have years back in relation to warfare and ordnance, First World War, I think that I would very likely prefer to take some job which was just as patriotic—maybe join the Army or something like that; I couldn't lose very much. This other way, what would I get?

Now, inasmuch as inventors are not below the average level of intelligence or patriotism of anybody else, but they are human beings like the rest of us, if we want to have our inventive system drop to the level of England and France, why, continue the act. But if we want to get, continue to progress and have some weapon that the Russians do not have, and it is about all we have got because they have covered our known knowledge and can do a very good job with the present knowledge—they have combed that—but the one thing they cannot get is American ingenuity. If you want to kill American ingenuity and put us on their level, just go ahead with this act, but if you want to beat the Russians, do everything possible to encourage every man in this country to invent and those that can do it well.

In closing, I want, from my long experience, to say something that Mr. Kettering, who had equally large experience as head of General Motors research, and being a man who sometimes expressed things well, he pointed out at that time they were attempting to put in the compulsory license provision, that the basic inventions do not come out of the big laboratories like General Motors. They come out of individuals, nobody knows where; but they come. That is, the original basic idea; and after that is invented, the big laboratories perfect it. It may need special materials. It always has many little improvements; many of them, in fact.

But whatever discourages the individual inventor over the country cuts off that great source of new ideas that flow into the established laboratories and which ultimately become commercial products; and it is something that the Lord himself set up and an invention is something that comes in one man's brain and, as Mr. Kettering said when his wife was expatiating on how wonderful it was that Lindbergh had flown the Atlantic and Mr. Kettering said that it would have been much more wonderful if he had done it with a committee. I have never seen a committee get together and invent something. Someone in the committee may have done something but it was just one man.

So I plead with this committee to do all they can to keep the channels open for the individual inventor.

Thank you.

Mr. CRUMPACKER. Thank you, Mr. Morse.

Our next witness is Mr. C. Willard Hays, appearing for the American Patent Law Association.

STATEMENT OF C. WILLARD HAYS, CHAIRMAN, LAWS AND RULES COMMITTEE, AMERICAN PATENT LAW ASSOCIATION, WASHINGTON, D. C.

Mr. HAYS. My name is C. Willard Hays. I am here as the representative of the American Patent Law Association. The American Patent Law Association is a nationwide group of patent lawyers having approximately 1,500 members.

The board of managers has authorized me to make this statement in opposition to H. R. 2560.

The purpose of H. R. 2560 is to continue in full force and effect the provisions of the Royalty Adjustment Act (35 U. S. C. 89–96, both inclusive), until 6 months after the termination of the national emergency proclaimed by the President on December 16, 1950. Unless so extended, it is understood that sections 89 and 90 of the act, providing for compulsory royalty revision and affording a remedy in the Court of Claims, will expire on July 1, 1953.

Answering several questions previously asked, I think that other sections of the act do not expire but are permanent legislation.

The Royalty Readjustment Act was originally enacted in 1942, as a wartime measure, under the war powers of Congress, to facilitate the production of materials and equipment needed for the successful prosecution of the war, and gave the heads of various departments and agencies of the Government the right to set aside private contracts entered into between citizens if, in the judgment of the Government, the royalties in such contracts were unreasonable or excessive, and gave the head of any such department or agency the right to fix and specify royalty rates which he might determine are fair and just, "taking into account the conditions of wartime production."

A patent owner whose royalties were reduced under the act was left with a remedy in the Court of Claims for fair and just compensation for the use of the invention by the licensee and the Government. In any such suit, the Government was given defenses which would not have been available to the licensee had suit against him under the original license agreement been permitted.

Thus, under the stress of wartime conditions and to facilitate procurement of materials and equipment necessary to the successful prosecution of the war, the rights of patent owners were very materially restricted, their contracts were altered at the determination of the head of a Government department or agency, or a board to whom the powers were delegated, and the patentee's remedies were very substantially limited and restricted.

Such interference with private business relations and such limitations upon established property rights may be justified during wartime, but, in the view of the American Patent Law Association, are not during times of peace, even though such times may be technically termed a period of national emergency.

It seems to be the present policy of Congress and the administration to relax price and wage controls, rent controls, material allocations and priorities, restrictions on building construction, and the like. The national emergency proclaimed by the President on December 16, 1950, does not at the present time seem to be sufficiently serious to justify the continuation of all of these controls. There is no practical need for the Government to continue the control of patent royalties, under the guise of a national emergency, to reduce the cost of the rearmament program, if the right to control prices of materials and labor is given up, since the latter are far greater items in the cost of defense procurement than patent royalties. Figures are not available, but it is submitted that patent royalties are an infinitesimal item, as compared to the cost of materials and services.

The Patent Royalty Adjustment Act in final analysis is simply an item of price control, and if other price controls need no longer be maintained, there is no justification for maintaining control over this species of property.

The American Patent Law Association takes the position that royalty readjustment should be effective, if at all, only during such times and under such conditions as justify a national program of stabilization of wages, prices, rents, and all other factors in our economy. Only during such critical times should the Government or its officers be authorized to modify the terms of private contracts by ordering reductions in royalties payable by licensees to patent owners under valid existing contracts, with respect to goods furnished to the Government. In practically all cases, such license agreements are the result of bona fide, arms-length negotiation between a patent owner and a licensee, and the rates of royalty are fixed as a measure of the value which the invention has contributed and as reasonable compensation to the patentee for the use of his invention.

Section 3 of the act of October 31, 1942, title 35, United States Code, section 91, is permanent legislation and does not expire on July 1, 1953, under the provisions of section 7 of the act, title 35, United States Code, section 95. This section authorizes the head of any department or agency to enter into an agreement with the owner of an invention for compensation to be paid, based upon future manufacture, use, or sale of the invention for the Government. Accordingly, even if sections 1 and 2 of the Royalty Adjustment Act are permitted to expire, contracting officers of the Government can inquire into the matter of royalties to be paid by a prospective contractor and, if the royalties are deemed to be excessive, may seek voluntary adjustment before the contract is let. If such an agreement cannot be made, the Government may procure the material or supplies from an unlicensed source and lease the patent owned to his remedy in the Court of Claims under title 28, United States Code, section 1498, the act of 1910.

If such voluntary readjustment of royalties cannot be secured, or if an unlicensed source of supply cannot be found, the net cost to the Government would probably be insignificant in any event, in view of the operation of the income-tax laws and the like.

The constitutionality of the Royalty Readjustment Act in other than time of war may be seriously questioned. The only cases in which the constitutional question was raised are *Timken-Detroit Axle Co.* v. *Alma Motor Company* (144 F. (2d) 714), and *Coffman* v. *Federal Laboratories* (171 F. (2d) 94), certiorari denied, both in the Third Circuit Court of Appeals.

In the Timken case, the court referred to "the governmental requirements for global war," page 717, and said "Total war, today is not a figure of speech but a grim fact." Also, it stressed "* * * the war power of the United States, expressly delegated to the National Government by the Constitution." Finally, it sustained the act, solely on the following ground:

> Our conclusion is that the statute is a constitutional exercise of the power of eminent domain by Congress in aid of its expressly granted war power.

This is found on page 719.

In the Coffman case, the same court said, on page 99:

> The core of the controversy, then, is whether the United States, in pursuance of its war power, can constitutionally take Coffman's interest in the patent, or the parts of that interest necessary for the Nation's wartime procurement program. * * *

Also, at page 100, it upheld the act on the following grounds:

The breadth of the war power needs even less exposition today than it did at the time of the Timken case in the light both of the recent decisions of the Supreme Court and the exposition of the war power which is found in the opinions.

And

The subject matter and purpose of the Royalty Adjustment Act are therefore clearly within the war power of Congress.

A study of these two well-considered opinions of Judge Goodrich leads to the conclusion that the law was sustained only on the basis of the war powers of Congress, and that similar peacetime legislation would be unconstitutional, as a violation of the fifth amendment.

For these reasons, the American Patent Law Association is opposed to the enactment of H. R. 2560.

Mr. TAYLOR. It is your position, is it not, Mr. Hays, that section 3 which at least leaves the door open for negotiation and provides for any eventuality, even if you have to wind up in the Court of Claims, is sufficient and that H. R. 2560 under consideration is unnecessary.

Mr. HAYS. Exactly.

Mr. TAYLOR. And do you have the same apprehension about H. R. 401, which is not presently under consideration, Mr. Cyr has, that if we enact this legislation, we let the Government put its foot in the door and we will later go on to 401 or something that is equally permanent?

Mr. HAYS. Yes, sir. And our association feels the same way; our association is opposed to H. R. 401. I have not prepared a statement on that because it is not up for consideration.

Mr. CRUMPACKER. Any further questions by members of the committe?

If not, thank you, Mr. Hays.

The next witness is Mr. Harry H. Hitzeman.

STATEMENT OF HARRY H. HITZEMAN, PATENT LAWYER, CHICAGO, ILL.

Mr. HITZEMAN. Gentlemen of the committee, my name is Harry L. Hitzeman. I am from Chicago, Ill. I am a patent lawyer and have been for about 25 years. I do not have a prepared statement but I want to go on record as favoring the extension of this law for these general reasons:

In the first place, I believe that we are still in a national emergency or in a state of war, if you please, and there are huge Government expenditures going on today as they were during World War II. They are drafting soldiers to send them to Korea to be killed and the other acts, other duties of citizens which are clearly indicative of the fact that we are still in a state of war whether it is called one or not.

Now, I do not have the background these other gentlemen do in negotiating these contracts, but in my own experience during World War II I can cite you a few instances of why the Government should have a right to negotiate royalty payments.

One instance was of a small firm in Chicago that got comparatively large orders for dart games which were purchased to be sent to the

recreation camps. The design patents on these games were owned by the three officials of the company and they proceeded to set the royalty rate to please themselves as they saw fit. They were the only bidder. They paid themselves royalties rather than pay dividends on stock owned in the company. Well, that is a danger you face unless the Government, as these gentlemen have previously said, has a club.

Now, as far as asking that a reasonable royalty be made on Government procurement, it seems to me there is a standard in almost every instance, almost every industry, I should say, of what reasonable royalties are. For example, I am somewhat familiar with the toy industry and the normal, average, reasonable royalty is around 5 percent, of course, depending upon volume; and the higher the volume goes usually there is an escalator scale and the lower the pro rata royalty payment becomes.

I think this law is strictly a checkrein by the Government on gouging, taking advantage of the fact that the Government is not in the same position of the prospective licensee which is a large company or any manufacturer. They deal at arm's length and if the inventor is not satisfied with what one man wants to pay, he will go to another. He will take the best bargain and they are going to drive the best bargain. Of course, the Government is not in that position. With them, it is a positive requirement. They need patented items. So they have to buy them.

Now, there has been some mention made by the previous gentleman about the 1910 and 1948 act under which the Government has the right to permit anyone to make your patented article and your only relief is a suit in the Court of Claims. I happen to have a suit there at this time and I want to say it is not difficult nor an unusually expensive procedure for any patent attorney.

There are instances where that law does not work. I can cite one this way. Out in Chicago there is a company I know that makes a special reseal cap for containers and they are the only ones that have the special machinery necessary to make it. If the Government would want those certain containers, and they did buy some during World War II, they would go to them. They could not go to anybody else because it would take months or years to make the special machinery to set up to produce. So that is not practical.

In conclusion, I want to say that I think as much of inventors' rights as do all the other gentlemen who have talked here. In fact, I have urged other relief for inventors before this committee in the past. I do not think the inventor is being unfairly treated. After all, this law simply provides a checkrein. As I have said, it gives the Government the right to interject themselves into a contract for Government purchases where they believe the royalty rate is unreasonable and I also believe that unless there is some basis for beliving it is unreasonable, the contracts probably would not be interfered with. The Government is not just a busybody that is interested in upsetting all the contracts.

I did some negotiating during the war on contracts for several of my clients and I never found the Government unreasonable. I think we can assume generally that the procurement offices would hardly interfere with a contract and want to reset the royalty unless there was some basis for it and that basis would probably be the fact that the

royalty rate was unreasonable and that because it was the Government, the manufacturer and the patent owner might or might not, deliberately or otherwise, be attempting to gouge the Government, legally, which it would be.

Thank you, gentlemen.

Mr. CRUMPACKER. Well now, I would like to consider a couple of these examples that you cited. Take the dart game, for example. I think I can probably state without reasonable fear of contradiction that the Government is not obligated or would not find it absolutely necessary to buy a dart game in order to carry out a war.

Mr. HITZEMAN. They bought them just the same.

Mr. CRUMPACKER. In doing so, they were dealing at arm's length with the producer. In other words, they do not have to have dart games since there are an infinite variety of games. If they could not get dart games at a reasonable price they could buy something else. So in dealing with the manufacturer of this game, they could determine—that is, the Government procurement officers could determine—whether it was a fair or reasonable price and if they did not think it was, they could just as well go somewhere else and buy something else, could they not?

Mr. HITZEMAN. Yes, sir.

Mr. CRUMPACKER. Now, in the case of the package containers where only the one manufacturer had the equipment to produce the particular item, it is true, it is not, that there are other laws under which the Government can seize the equipment or in effect draft factories and force them to produce particular items in war emergencies?

Mr. HITZEMAN. I think you are right.

Mr. CRUMPACKER. And in cases where there might be an excessive royalty involved, particularly in corporation cases, would not a substantial part of the excess be recovered in normal taxes, income taxes, and excess-profit taxes?

Mr. HITZEMAN. Yes, sir. I have heard that stated all morning; but it seems to me that it is an indirect way of preventing waste of taxpayers' money. I feel that the Congress is a trustee of the taxpayers' money and should use, and I think it does use, all reasonable care and precaution to prevent waste of them. And I do believe that it would be a waste of taxpayers' money to pay exorbitant license, or exorbitant royalties just because the purchaser is the United States Government.

Mr. FINE. I do not remember, but did you indicate whom you represented here this morning?

Mr. HITZEMAN. No; I did not say I represented anyone, sir. I just said I was Mr. Hitzeman from Chicago, a patent lawyer.

Mr. FINE. Do you represent anybody?

Mr. HITZEMAN. Not at this hearing, except you might say the general patent people I have dealt with and what I strongly feel about the bill personally.

Mr. TAYLOR. There has been some testimony here, Mr. Hitzeman, regarding incentive. Have you observed that anyone has failed to take out a patent merely because of the existence of this act.

Mr. HITZEMAN. No, and I think it is merely straining at the meaning of the word; I do not believe most people's incentive to invent is the thought that eventually they will get a contract with the Govern-

ment so that they can collect a lot of royalties. I do not believe that that is in an inventor's mind when he is thinking about inventing.

I also feel that while our patent system is pretty good, it needs some remedies and this is certainly not very detrimental to inventors' rights in this country. There are other far more serious defects in our patent system.

Well, that is all I have.

Mr. CRUMPACKER. Thank you very much, Mr. Hitzeman.

Mr. Lanham is our next witness.

STATEMENT OF FRITZ G. LANHAM, WOODLEY PARK TOWERS, WASHINGTON, D. C.

Mr. LANHAM. Mr. Chairman and members of the committee, my name is Fritz Lanham. I represent the National Patent Council which is a nonprofit organization that is interested in safeguarding our patent system in its operations as intended by the fathers.

This organization is composed of smaller manufacturers.

Let me bring to your attention that small business in this country is very much dependent upon the protection of the use of its patents. We look upon an automobile as one finished product. As a matter of fact, 50 percent of the component parts of that automobile are furnished by small business.

I think I may say also that I represent myself as an American citizen devoted to the preservation, the promotion, and the protection of our patent system as the predominant basis of our industrial progress and development.

As some members of the committee know, it was my pleasure and privilege to serve for approximately 25 years of the 28 years that I served in the House of Representatives, before my voluntary retirement, as a member of the Committee on Patents, and I came through that service to realize the great importance of the protection and the preservation of this American patent system.

Let me remind you by way of preface that in the Constitutional Convention there was never the slightest controversy or question or debate with reference to the necessity of protecting those who would invent things useful for the development of this country. That fundamental law and practice and policy have come on down through the years and we certainly should resist any effort to weaken or impair that wonderful system which has differentiated us so advantageously from the various nations of the earth.

Now, this bill, H. R. 2560, was introduced by the chairman of the Committee on the Judiciary, my very good friend. Inasmuch as for quite a number of years I served as the chairman of a committee of the House of Representatives, I realize that it is practically incumbent upon a chairman to introduce for consideration such as they may deserve any legislative proposals which are submitted to him by the governmental departments and, consequently, such action involves no idea of sponsorship. As a matter of fact, this very proposition has been before this committee in the last Congress or two and, very wisely in my judgment, it has declined to report it.

I wish briefly, and to conserve your time, to give you three reasons in particular why this bill should not be passed:

That it is unnecessary; that it is unwise, and that it is unfair.

I think it is very doubtful whether this proposal ever should have been enacted in the beginning. The reasons why it is unnecessary have been cited and I shall not dwell upon them. The first is that practically all of these matters can be settled by negotiation. The Government is dealing with patriotic citizens who are interested in trying to be of such service as they may to the Government. Their labors and their efforts in creating these inventions indicate that fundamental purpose.

And so, it is unnecessary because by negotiation most, if not all, of these questions can be determined. But if they cannot be so determined, still by the law of 1910 the Government under our present patent laws can take anybody's patent and manufacture under it and the patent owner has as his remedy a suit in the courts.

Mr. CRUMPACKER. May I ask at that point, is that provision part of the general patent law or is it contained somewhere else in the code?

Mr. LANHAM. It is retained in the revision of the patent laws.

Mr. CRUMPACKER. Was it in the revision that we passed last year?

Mr. LANHAM. It was. I have here a copy of the revision of the patent laws, and not only is it in the revision of the patent laws but we have had it as patent law ever since the enactment of the 1910 act.

Not only is this legislative proposal unnecessary, it is unwise. In the first place, when we are dealing with a fundamental institution of this Government like our patent system, so responsible for our growth and progress, to take an emergency measure and of doubtful necessity originally, make that the permanent law of the land is on its face untenable; and it is certainly unwise by so doing to reduce the incentive of the inventors of this country to continue to invent things that are useful for the Government rather than for nongovernmental commercial purposes merely, and that was very forcefully shown by a previous witness. It is unwise to make this law permanent, and especially when we are dealing with a fundamental institution like the patent system that we have had from the beginning of this country and which has forged us far ahead of the other nations of the world. That creative incentive must not be impaired.

Now, it is unfair because, as a matter of fact, it varies a Government contract inherent in the very issue of patents and the rights of patentees thereunder.

The law provides what the rights are under a patent. The Government grants that patent and why should the Government be allowed to violate at will the terms of that contract? I think that is eminently unfair.

The second reason it is unfair is that there is no reasonable force or philosophy in the contention that a patentee may make too much money in the opinion of somebody, somewhere in the Government, unfamiliar with the operations of our patent system; someone who thinks that the remuneration is going to be excessive.

Let me make a little contrast there. Now, this man who has invented something useful for the Government has done a great service.

Now, let us suppose that here is a man—and we all know that there are many cases of this character—who has never done anything of consequence for the Government or perhaps for anybody else, but he owns a little piece of land and they discover oil on that land and he begins to get financial returns that are very, very abundant, much

greater than would come to the patentee who has labored so hard to be helpful to our Government.

What does the Government say to him? Does it say, "You are making too much money"? Oh, no, no. It says, "We are going to protect you. We are going to give you—properly, of course a depletion allowance that will make your returns even greater because that oil well will not last forever." And let me call it to your attention that the patent does not last forever; it is only for a limited term of years, and thus far no depletion allowance has been granted a patentee.

So the fellow who has been useful to the Government is to be told by this bill, "You are making too much money." But the fellow who gets the oil well and who has done nothing for the Government is never told, "You are making too much money." They tell him, "We want you to make all you can and we are going to protect you in making it because we are going to get from you, just as we get from the patentee, a whole lot of that money back in income taxes."

Why differentiate between them, one having done so much for our Government and the other having done practically nothing?

Now, the provisions of this bill are absolutely contrary to all our business and commercial practices. The seller and not the purchaser sets the value of the article that he wishes to sell. You go into a store to buy something—and I don't care what it is—they tell you what you are going to pay for it. You do not tell them what you are going to pay for it. You can haggle with them, perhaps, and maybe get it reduced, just as by negotiation, if there is a great demand for his product, a patentee may agree to a reduction of his normal return. And let me call your attention to the fact that this authority as set forth in this bill can be delegated by the head of any department or any governmenal agency to anybody he pleases, and in many instances, of course, that could be to someone who knows little about the operation or importance of the patent system, so the patent owner and manufacturer are told, "We are going to pay you this; this is all we are going to pay you, and you can go into the courts in expensive litigation if you wish to try to get your normal royalty."

I do not think they are going to come and cite you any cases where a patentee is endeavoring to get more than is paid by way of royalty under normal license agreements.

Let me say, too, this: that it has even happened, and I cited such a case in a former appearance against a similar measure before this committee, that in order to force the patentee to lower his royalty price, they can tell him that they do not think his patent is valid. That has happened. It has happened, as stated, in one instance which I cited in former testimony here. So the patentee went to the Court of Claims, and the Court of Claims forced the Government rightfully to pay him what was properly due.

We are dealing here with something that is fundamental. Our patent system must continue just as the fathers intended it from the very beginning. It must be protected. We have got to encourage and continue the incentive that that patent system affords the people of this country to do things to keep our Nation in the forefront.

I think it would be a great disservice to this country for this act to be continued and I certainly trust that the committee will do as it

has done heretofore, decline to give favorable report to measures of this character.

Thank you, Mr. Chairman.

Mr. CRUMPACKER. Thank you, Mr. Lanham.

I wish at this time to file three statements to be part of the record, one by the Cleveland Patent Law Association, one by Carlton Hill, and one by the Young Republican Club of the District of Columbia.

The Cleveland Patent Law Association says:

This is to report that on April 9, 1953, at a regularly designated meeting of our association which comprises approximately 175 patent attorneys in the Cleveland-Akron-Canton region, the legislative committee, after having studied the problem, stated that they were against House of Representatives bill H. R. 2560 for the extension of the Royalty Adjustment Act. Upon a motion, the entire assembled body of patent attorneys voted unanimously against the extension of the Royalty Adjustment Act.

Mr. Carlton Hill, who is technical adviser to patents and trademarks committee, Illinois Manufacturers Association, says, in his statement dated March 16, 1953:

H. R. 2560 which was introduced in the House of Representatives by Mr. Reed of Illinois on February 3, 1953 and which was referred to the Committee on the Judiciary as a bill to continue the effectiveness of the provisions of the act of October 31, 1942, as extended, relating to the adjustment of royalties, for the duration of the national emergency proclaimed December 16, 1950, and 6 months thereafter.

At the outset it is to be noted that this is an attempt to secure an "indefinite" extension of emergency legislation which has already been extended under the resolution adopted by the Congress and enacted into law on July 3, 1952 until April 1, 1953.

The wartime Royalty Adjustment Act, which is thus sought to be extended, gave the head of each Government procurement department or agency the right to investigate patent royalty agreements, where royalty is included as an item of cost in a Government contract, and to revise the stipulated royalty rate to suit the judgment of such department or procurement head regardless of abrogation thereby of existing agreements between United States citizens.

It has been seriously questioned whether or not the legislation now sought to be extended does not constitute such an encroachment upon the constitutional rights of individuals as to be objectionable even in time of war. The Committee on the Judiciary, in its report No. 2041 on the Emergency Powers Continuation Act observed in this connection:

"The committee is mindful that such intervention on the part of the Government is an invasion of the right of contract between the licensor and the licensee; a contract to which the Government was not a party."

Certainly, there seems to be no such emergency now existing as to warrant such derogation of property rights, particularly where it dilutes the incentives held out to inventors and tends to discourage the making of inventions which might be invaluable to our country if an emergency should arise.

It is, therefore, believed that this extension of this emergency right should be opposed for the following, among other, reasons:

(A) It is not believed that there now exists such an emergency as to warrant such legislation; and

(B) The legislation sought to be extended contains objectionable features.

Among objectionable provisions and features of the legislation, the following may be noted:

1. The determination of rates and amounts of royalties is vested in a party interested in having those rates lowered.

2. There is no requirement in the law that the determination be explained or justified.

3. An aggrieved licensor has no right of appeal from such a determination, has sole remedy being by way of a suit against the Government.

It is further believed that the extension of this emergency legislation, which does not seem to be warranted by existing conditions, would be harmful to our economy and by tending to discourage the making of inventions would assist

in defeating any sincere effort to strengthen our national economy and defensive position.

Now, William G. Konold, subcommittee chairman, American patent system, the Young Republican Club of the District of Columbia, under date of March 25, 1953, has this to say:

We, the subcommittee on the patent system of the Washington, D. C., Young Republican Club, are writing to advise you that we oppose H. R. 2560 providing for the extension of the Royalty Adjustment Act. Unfortunately, we have not had an opportunity to present this question to the Young Republican Club as a whole nor to the board of the club. This letter represents the opinion of the committee.

When originally enacted, the Royalty Adjustment Act was a World War II emergency measure. The act was designed to adjust royalties which, while perhaps reasonable in peace time, became so high as to adversely effect the war effort because of the unprecedented high production of patented equipment.

The act, in fact, begins with the statement "To aid in the successful prosecution of the War."

The situation which existed at the time of the original enactment does not exist today. There is now ample time for the Government to plan schedules of production so as to know what quantities of material must be procured. There is time to negotiate with the manufacturer to agree on a reasonable price for supplying such material. The Government has time to ask the manufacturer to renegotiate with his patent licensor for a sliding scale of royalties if it appears that the quantity of material to be supplied will be considerably higher than originally contemplated by the licensor. In other words, there is not now the tremendous urgency of a full-scale war which requires such extreme measures as the Royalty Adjustment Act inflicts on American business.

Recognizing that fact, the President and the Congress have been permitting as many wartime controls to expire as are consistent with the national health and security. When he requested that controls be removed, the President considered the fact that we were engaged in a cold war with Russia and an actual conflict in Korea. But he nevertheless believed that the strained conditions would exist for a long time and that, if the country were to remain economically healthy, competitive enterprise must remain as free as possible from governmental intervention and control.

To permit the Royalty Adjustment Act to expire is not only consistent with the present policy, but is important to the Nation's economic well-being. Congress, as recently as 1952, has recognized the importance to our country of having a strong patent system and, accordingly, has enacted the new Patent Laws, title 35, U. S. C., with new provisions designed to strengthen the patent system. It would be inconsistent with the congressional acknowledged necessity of a strong patent system to extend the Royalty Adjustment Act. The act considerably weakens the patent system by placing in the control of the heads of Government agencies and departments the amount of royalty the patentee may obtain from a licensee who has a contract with the Government to manufacture, use, or sell the patent item.

Thus, the effect of the act is to diminish considerably the value of the patent and with it the incentive to invent new and improved processes, machines, et cetera, which would be useful to the Government. The diminution of the incentive to invent works two ways. First, the inventor or the company is unwilling to spend time and money on research and development where, at the whim of the bureaucrat, the inventions resulting from the research may not bring a return sufficient to make such research profitable. Secondly, when the Government can arbitrarily set its own royalty, there is no incentive to invent a substitute which will not infringe the patent claims. Thus, as far as inventions useful to the Government are concerned, the desire or necessity for finding new and useful improvements is substantially reduced at least partly because of the Royalty Adjustment Act.

The argument has been presented to our committee that, when a really valuable invention is patented, it would be very costly to the Government to pay large royalties to have it manufactured and the act is necessary to prevent this situation. This argument has for its basis the proposition that the patent system should protect strongly only those inventions of little value. It ignores

the fact that, if the invention is of exceedingly great value to the Government, then it is worth the payment of a reasonably high royalty for its use. The argument also ignores the fact that, in the case of great necessity, the Government can proceed with the procurement of the patented goods, and the patentee can seek reasonable compensation in the United States Court of Claims.

There is no validity to an argument that the act is necessary to prevent royalties from being all out of proportion to the value of an invention, because we are not now engaged in superproduction not contemplated by the parties when the original royalties were established. Therefore, to state that the act is now necessary is to state that it is always necessary in peacetime or war.

Our committee respectfully submits that we must attempt to preserve peacetime rights and, as far as possible, governmental interference with free negotiations in competitive enterprise should be eliminated. The expiration of the Royalty Adjustment Act will be a step in that direction and will be in accord with the administration's policy of elimination of governmental controls.

I would like to state further that the record will be kept open for a period of 5 days during which any interested parties may file supplemental or additional statements to those previously given.

(The following communications were submitted for the record:)

MILWAUKEE, WIS., *April 29, 1953.*

HON. KENNETH B. KEATING,
Chairman, Subcommittee on Patents of the Committee on the Judiciary, House of Representatives, Washington, D. C.:

The Milwaukee Patent Law Association representing 94 Wisconsin patent attorneys wishes to express its opposition to H. R. 2560 on the following grounds: (1) there is no valid reason for singling out patent owners as a special class of contractors subject to having an arbitrary value placed upon the patent res of the contract by a Government department head after the contract has presumably been bargained for at arms' length and then put patent owners to the expense of final adjudication in the Court of Claims; (2) there is no valid reason for singling out patents as a special class of property subject to restrictive legislation of this character; (3) wartime legislation, no matter how beneficial, and this act is not so conceded, should not be continued during peacetime. The Royalty Adjustment Act was originally enacted to remain in force only during the continuance of World War II and for 6 months thereafter; (4) the Renegotiation Act of 1951 affords the Government sufficient protection against contractors making excessive profits; (5) the Royalty Adjustment Act places far too much power in the hands of Government department heads and lends itself too easily to abuse in the hands of inexperienced, arbitrary, or incompetent officials; and (6) the act in peacetime is likely to promote litigation and increase the expenses of Government and business alike.

ADRIAN L. BATEMAN,
Secretary, Milwaukee Patent Law Association.

MARCH 20, 1953.

HON. KENNETH B. KEATING,
Chairman, Subcommittee No. 3, Judiciary Committee, House of Representatives, Washington, D. C.:

The Patent Law Association of Los Angeles is strongly opposed to the passage of H. R. 2560 and any other legislation that would extend the Royalty Adjustment Act beyond April 1, 1953. It is our considered opinion that extension of that act is unnecessary under existing conditions. Other statutes including Renegotiation Act and 28 United States Code 1498 fully protect the Government's right to use patented inventions without payment of excessive royalties.

A. T. SPERRY, JR.,
Secretary-Treasurer, Patent Law Association of Los Angeles.

AHLBERG, WUPPER & GRADOLPH,
Chicago, April 28, 1953.

Re H. R. 2560.

Hon. KENNETH B. KEATING,
House of Representatives, Washington, D. C.

SIR: I am writing to place on record my opposition to the pending legislation to continue unchanged the Royalty Adjustment Act of 1942 as amended.

It seems to me that the Royalty Adjustment Act is based on the unsupportable theory that an inventor, whether he be a patent holder or not, is not entitled to the reward he has earned for the fruits of his labors, but is entitled only to that which a Government administrator determines he shall receive. Those in the Government who support this legislation are not to be counted among the friends of the American patent system and free enterprise. On the other hand, they endorse the position of the Government's supremacy in all things and particularly the point that the Government should dictate what income a man should have. This is not the philosophy that made this Nation great, nor is it a philosophy which will continue it at its present level.

This law ignores the proposition which has been demonstrated to be true since the very earliest days of the American patent system, that a royalty fairly and openly agreed at, between an inventor and his licensee, is usually a just royalty; and any attempt to interfere with these open and free negotiations benefit no one. Also one should not lose sight of the fact that the Royalty Adjustment Act invades the sanctity of the contract by telling the licensee that he may not pay the royalty which he had agreed upon with his licensor but must pay a royalty which is fixed by a Government administrator.

Not only do I consider the Royalty Adjustment Act morally unsupportable, but its administration is unfair. Those who adjust the royalties are quick to realize their power and no reasonable man can deny that they have an opportunity to be unreasonable, arbitrary, and dictatorial.

Furthermore, many who have operated under this law in the past are woefully incompetent to deal with the cases that arose. I personally am acquainted with one man who is now engaged in the private practice of law but who during the war handled royalty adjustment cases. This individual is not a businessman and by his own admission he knows nothing of patents. His qualifications are hardly suitable for the job he was assigned to do during the war.

During the past 20 years the members of Congress have been strong friends of the American patent system and have stood strongly against its enemy. The new Patent Code is a mark of that friendship. Now I believe the enemies of the American patent system and the creeping socialism of the previous administration can be turned back by refusing to enact H. R. 2560 into law.

I would greatly appreciate it if this letter can be made a part of the record of the hearing on this bill.

Very truly yours,

JOHN T. LOVE.

DAYTON, OHIO.

Representative PAUL F. SCHENCK
House Office Building, Washington, D. C.:

Pending bill H. R. 2560 proposed by Mr. Reed Illinois means further confiscation of our property. Partner and myself have been denied royalties since 1942 on heavy duty universal joints for aircraft and so forth which we invented successively improved for and successively standardized by all military agencies of our Government. This covers 12 years. If there ever was there is now no excuse for continuing this confiscatory interference between licensor and licensee long imposed by Defense Department procurement authorities. Thanking you

KENNETH G. FRASER.

ASSOCIATION OF PROFESSIONAL PHOTOGRAMMETRISTS,
Washington 6, D. C., May 4, 1953.

CHAIRMAN, COMMITTEE NO. 3 OF THE COMMITTEE ON THE JUDICIARY,
Old House Office Building, Washington 25, D. C.

(Attention Mr. William R. Foley, counsel.)

GENTLEMEN: This organization represents small business, though at the same time, 70 percent of the productive capacity in the United States of our profession which takes aerial photographs and makes maps for transport routing, construction planning, and resource and other surveys from such photographs.

We desire to protest the extension of H. R. 2560. We are convinced that if the right of Government agencies, as provided in H. R. 2560, is extended so that they may adjust royalties under Government contracts our profession, which is of such importance to the defense effort, will suffer.

So long as renegotiation provisions continue to go into a contract, we can see no logical way of separating royalty cost from other cost items. Further, if the contractor is under royalty agreement with a third party, which agreement may well have antedated the national emergency, and very probably antedated the contract in question, it seems improper to subject this royalty agreement to question.

In a broad sense, H. R. 2560 places in the remote, inexperienced hands of Government bureaucrats a means of interfering unjustifiably with the private property rights of citizens.

The undersigned has read the transcript of the hearing, held on April 29, 1953, by your committee. We endorse categorically the testimony of Messrs. Parker, Cyr, and Ballard.

Sincerely,

FOWLER W. BARKER,
Secretary.

Mr. CRUMPACKER. If there is nothing further, the meeting is adjourned.

(Whereupon, at 12:15 p. m., the meeting was adjourned.)

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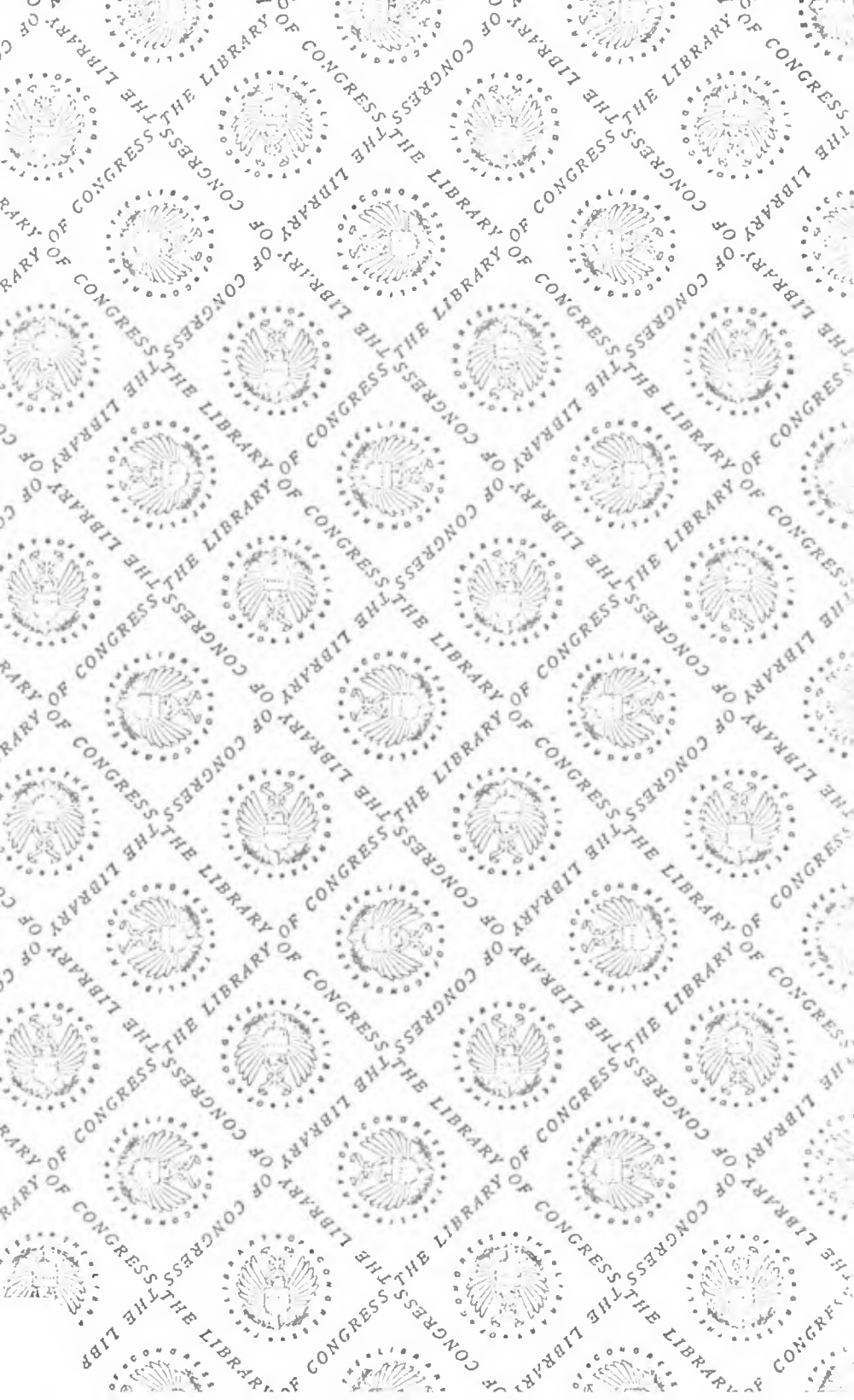
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